<u>Università Bocconi thesis</u>

"Behind the consolidation of the luxury market: The critical role of conglomerates and their decisive impact on the industry's destiny"

Tutor: Gimede Gigante

<u>Stockholm School of Economics thesis</u>

"The non-effect of IFRS-16 accounting standard on the valuation of luxury companies"

Tutor: Gualtiero Azzalini

<u>Università Bocconi thesis</u>

"Behind the consolidation of the luxury market: The critical role of conglomerates and their decisive impact on the industry's destiny"

Tutor: Gimede Gigante

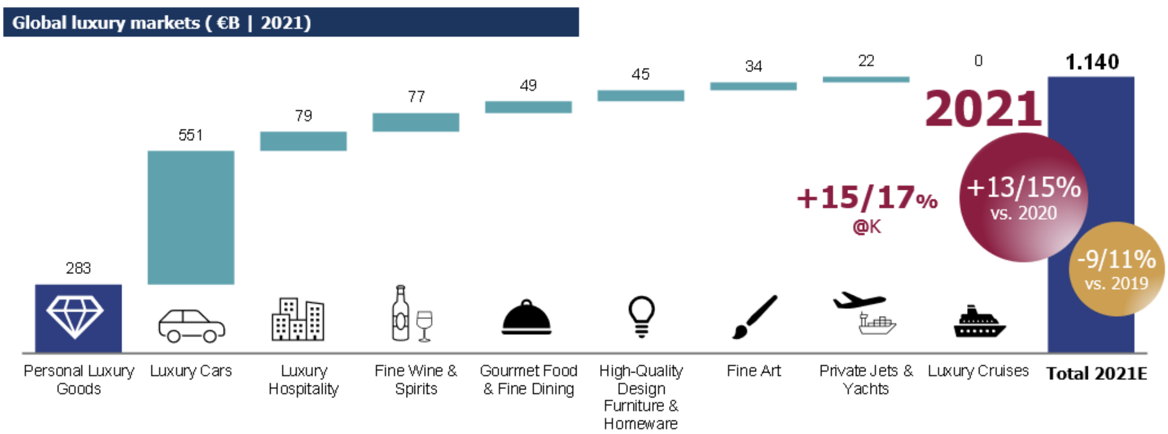
Contents

1. Introduction to the luxury market

Accounting for more than €1.1T in 2021, the nature of the luxury industry at large does not have the traditional boundaries as other industrial sectors have. It cannot be defined by specific goods, services or business processes: the luxury industry is rather characterized by its market positioning (high-end) and its transversality, as it incorporates those goods and services – which we define "luxurious" – included in other industries. It is scholars' duty to investigate the bounders which distinguish luxury from non-luxury and, from their research, one can appreciate how many different levels exist between necessity (or normal) goods and luxury (or superior) ones.

Since the 1970s, the luxury sector has been amongst the fastest growing industries and one of the strongest forces for Europe to strengthen its competitiveness worldwide. According to the annual reports drawn up by the consulting firm Bain & Company in association with the industry-specialized organization Altagamma, revenues from the luxury sector have been growing steeply from €77B in 1995 to €173B in 2010, reaching almost €1.3T in 2019, just before the Covid-19 pandemic.

As below, there exist nine luxury sub-markets: Personal Luxury Goods, Luxury Cars, Luxury Hospitality, Fine Wine & Spirits, Gourmet Food & Fine Dining, High-quality Design Furniture & Homeware, Fine Art, Private Jets & Yachts and Luxury Cruises.



Source: Bain & Company, Altagamma (2021). Luxury Goods Worldwide Market Study, Fall 2021 – 20th Edition

In the following pages, I am going to analyse each of these sub-markets, focusing on the personal luxury goods one. As a matter of fact, even if its contribution is not the largest one in terms of volume of sales amongst all the sub-markets, personal luxury goods represent the forerunner of the whole luxury industry and, for the purpose of this thesis, it is the segment where the most interesting conglomerates operate.

1.1. The meaning of luxury across time

The term "luxury" derives from the Latin word "luxoria", i.e. exuberance, excess and abundance. In Roman and Greek thoughts, however, it did not represent a neutral term: in fact, one could find it within a moralized vocabulary with the meaning of corruption of virtue. When temperance and continence were judged amongst the most important virtues a man should have had, luxury was considered to threaten and compromise the qualities that – in practice – should have been translated into a life of poverty, frugality and austerity, condemning desire over necessity.

In the early modern period, the gradual process of de-moralization of luxury was part of a wider shift in philosophical thinking about human nature. Once recognized that desire, aspiration and aversion can be regularly and constantly identified within human motivation, luxury goods started to gain an opposite meaning compared to the ones assigned by Stoics: they play the positive role of aspirational incentives and, in times when desire is associated to pleasure, they are considered a source of value to any individual.

In recent years, expensiveness, quality and elegance are just a few of the attributes which one could think about if asked "What does luxury mean to you?".

However, according to Franca Sozzani, former editor-in-chief of Vogue Italia, thinking of luxury in this way - misunderstanding it with the "richness" associated with expensive items - one could risk confusing it with an old idea of luxury.

Defining what "luxury" stands for today is not the easiest task: certainly, some of the features characterizing this term are no longer valid. Luxury is now bygone a "richness symbol" only: for instance, one can wear or own any kind of luxury item without looking "luxury". He only looks rich, possibly even vulgar.

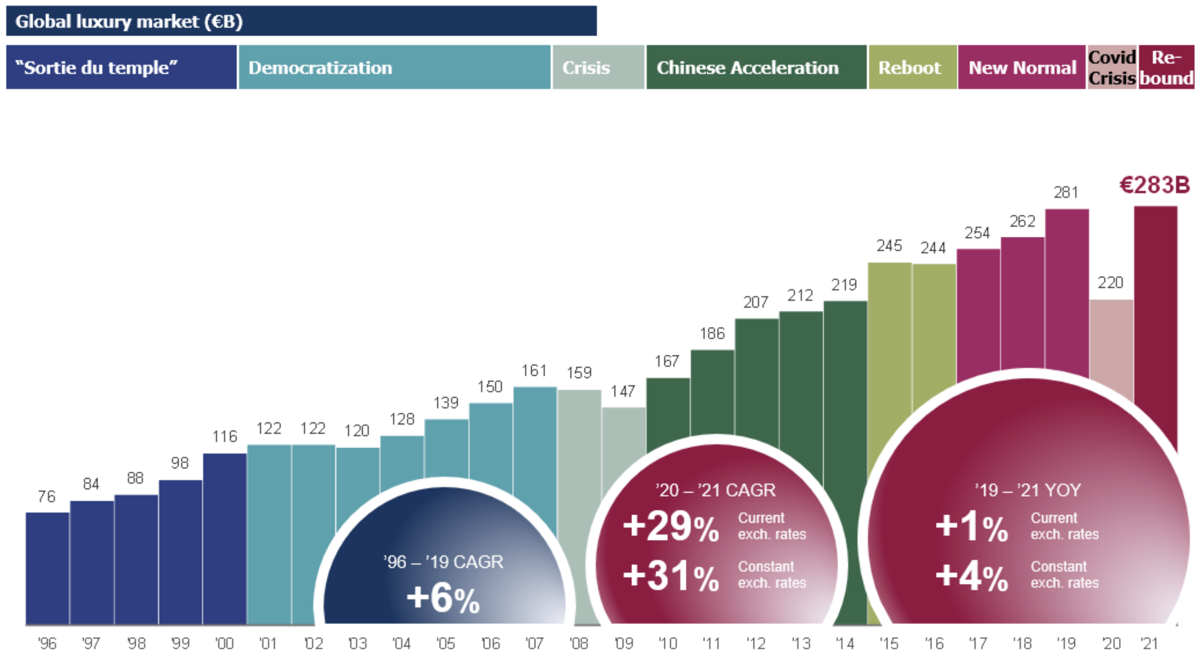
The attributes of luxury have evolved from its "rich-looking" fundamental requirement to more specific ones, based on customers' awareness of the product and on the feelings generated from owning it: exclusiveness, uniqueness, heritage but also research and new routes. These are some of the features one should look at when trying to define luxury today.

1.2. State of the market: winning and losing segments

Due to the transversal nature of the luxury market, products and services belonging to different industries (e.g. consumer goods, automotive, food & beverage) can be found within the whole luxury industry. To rationalize this transversality within the industry, one could decide to categorize products and services in sub-markets according to their nature rather than to their market positioning. It is simply the inverse procedure of classifying products according to their market positioning within the same industry.

Starting from the oldest one, Personal Luxury Goods (e.g. apparel, jewellery, watches, cosmetics and fashion accessories) represent the first real market for luxury products. Such goods have always been traded internationally and this segment is a true pioneer of the globalized economy: commerce of such goods (e.g. silk, precious metals garments, Tyrian purple tint) can be traced back to the inception of civilization c.5,000 years ago.

Analysing the past decades, one can appreciate that this segment has experienced constant growth: from €76B in 1996, global sales have reached €283B in 2021 after a strong V-shaped re-bound from the pandemic crisis, which cut by 25% volumes in Q12020. This acts as a strong predictor of healthy growth in the short to medium term, with global sales predicted to touch c.€380B in 2025.



Source: Bain & Company, Altagamma (2021). Luxury Goods Worldwide Market Study, Fall 2021 – 20th Edition

If Personal Luxury Goods have gone through the Covid-19 crisis decently, recovering the loss in sales experienced during 2020, other segments have overcome their 2019 level thanks to new needs and tendencies created by the pandemic. On the other hand, some segments have not been able to reach the 2019 level yet as some habits or activities are no longer "usual" for consumers.

Amongst the "winners", High-quality Design Furniture & Homeware has been the only sub-market able to grow significantly from 2019, i.e. +6/8%. Its growth can be mostly attributed to the so-called "cocooning effect", the increased relevance of homes following the pandemic. The continued refocus of consumers' spending on home, already started at the end of 2020 after the first lengthy lockdowns, has driven up expenses for luxury design items to decorate and furnish customers' own "cocoons", a place of increased importance thanks to its safety and warmth attributes.

Similarly to Personal Luxury Goods, whose growth has been negligible from pre-to post-pandemic levels (i.e. 2019 vs. 2021), Luxury Cars (+0/1%) and Fine Wines & Spirits (+0/2%) have rebounded similarly from the plunge in global sales. While the former segment has been further penalised by factors different from the Covid-19 pandemic (i.e. supply scarcity in key components), the latter has been mostly penalised by changing habits of customers and forced closure of restaurants. However, the two segments have been able to recover significantly in 2021, thanks to increased interest in the Luxury Cars segment (+7/9%), driven by new disruptive brands entering the market, and to an increasing interest in "status" spirit as out-of-home spending turns at-home within the Fine Wines & Spirits segment (+12/14%).

On the other hand, some categories have suffered the shift in customers' behaviours more than the previous ones. Specifically, the Luxury Cruises market - also hit by exogenous restrictions from local governments – has experienced the steepest fall ever from 2019 to 2021 (i.e. -40/42%). The progressive loosening of travel limitations and social distancing is proving to support the rebound of this market – with order book for the current year approaching 2019 levels – even if customers' preferences have shifted towards Luxury Hospitality, which has increased significantly after the Covid-19 pandemic (+20/22% from 2020 to 2021).

1.3. The luxury consumers

Panta rei. Everything flows. As the famous aphorism attributed to Heraclitus says, everything evolves: new technologies, sensibilities and circumstances have changed the needs of luxury consumers and – because of some exogenous factors such as the Covid-19 pandemic – the speed characterizing some of these transitions has been tremendous.

After having analysed how the industry's volumes have moved due to new forces and trends, we should focus on *who* is asking for those changes, which are shaping a renewed industry.

What once was a niche market, characterised by a specific target audience, is now fastly shifting into a fragmented industry with a complex and multi-layered consumer. First, the luxury customer base no longer consists of the upper-echelons of society: older generations, Gen X and Gen Y are permanently leaving or resizing their role within the luxury market as they are now progressively living a harder reality made of loans, parenthood, tuitions for children at college, ageing relatives and a general resizing of their budget for leisure goods in favour of necessity ones.

Contrastingly, younger Millennials and Gen Z are entering the workforce and their spending power is increasing substantially: they are now making up 35% of the luxury market and, by 2025, they are forecasted to account for more than 50% of the whole market.

As a consequence of new generations entering the customer base and old ones abandoning it, luxury brands need to adapt to changing everyday necessities, lifestyles and mindset. Specifically, the latter has drastically changed from how it was a century, or even thirty years ago. Luxury purchasers, just as many retail shoppers across several service segments, are experiencing an increased awareness about new hot topics such as climate change, social and political issues. Consequently, also luxury consumers will shift their loyalty to their favourite brands depending on the actions and initiatives carried on by luxury companies, which will have to act accordingly to not lose consent among their followers.

As a result, the common trope of the luxury consumer - once represented by a Dom Perignon-sipping, gold sequins dress-wearing woman living during the Belle Epoque, later evolved towards the Prada-totting female celebs of the new millennium (fifteen years ago, 80% of luxury shoppers were female) - has now been replaced by new different archetypes, reflecting the diversity of the current luxury consumer base.

Mostly Millennials, equally divided by gender according to ForwardPMX (2019), a large share of 'new' luxury consumers are *HENRYs*: High Earners, Not Rich Yet. Recently, as owning luxury items has become a way to demonstrate its wealth or status, the luxury shopper is no more the 'rich'. According to Johnson and Vigneron (1999), purchasing luxury products represents indeed a prestige-seeking behaviour. Therefore, in practice, lower income consumers will consider purchasing a luxury item to show-off a social status they may have not reached yet. At the same time, often HENRYs do not 'feel' rich at all, despite their efforts to show this off to society: they are highly indebted, all their savings are spent on unnecessary purchases and they are working full-time to gain what they need to perpetuate this fiction. This represents a huge shift in the luxury consumer base and, in the following paragraphs, we are going to analyse the reasons behind luxury purchasing.

After having analysed who luxury consumers are, we will briefly study their psychographics, which will reveal the reasons behind their purchases.

The major characteristic associated with luxury consumption is irrationality. As anticipated when defining what luxury stands for, luxury purchases are not pursued for necessity, but only from the hedonism one can derive when completing the purchase. Again, this is what distinguishes purchasing luxury goods from buying a dishwasher or an oven – which represent the perfect examples of utilitarian purchases. Then, luxury purchasing behaviour is completely bounded to emotions and feelings: completing the purchase of an expensive luxury item brings excitement and pleasure. Moreover, along with these hedonic feelings, the luxury buyer will feel empowered and highly satisfied from gaining an elite, rare, or high-quality item. Therefore, if one wanted to identify the three main driving motives of luxury purchases, they would be:

- *The need for uniqueness*: the luxury good has to be scarce, exclusive, rare and the demand associated with it has to be excessively higher vis-à-vis its supply, possibly driving the secondary-market price substantially higher than the retail price;
- *Costly signalling and status*: a luxury good serves the aim of signalling wealth and validating status and self-worth, while affirming to other people to belong to an in-group of elite shoppers (i.e. prosocial signalling);
- *Building up the self and self-narrative*: luxury goods are the ultimate symbols of the self. As stated above, they symbolize all self-driving factors such as status, wealth and uniqueness and they contribute to bring the aspirational individual closer to the perceived ideal self they want to realize when purchasing luxury products.

1.4. Upcoming trends for luxury players

As analysed in the previous paragraphs, the composition of the luxury consumer base has deeply shifted from upper-echelons of society to young professional HENRYs exploiting luxury products to gain their place in society.

Therefore, there are now new different demands on luxury brands vis-à-vis the ones of twenty years ago. While some traditional attributes and values are still key and necessary for luxury brands to stand out, the new class of consumers is now looking for their purchases to declare a message, building up a various set of expectations. Furthermore, luxury brands need to adapt to new consumer habits and sensibilities across several aspects of their operations, from communication to distribution.

First, following the Covid-19 pandemic, social restrictions and store shut-downs, the traditional brick-and-mortar model characterizing the luxury industry lose its primary role to attract and retain customers, who were forced to move online. However, this was not as smooth as buying toothpaste on Amazon was as, for the luxury purchaser, the shopping experience held a certain relevance. As a result, luxury brands started questioning themselves on how to make "luxurious" a cold and impersonal purchase behind a computer. Major luxury brands are deploying significant capital to develop competencies within AI technologies such as chatbots, social media, personalization engines, conversion optimization and other tools, in order to keep up with luxury shoppers claiming tailored, fast and easy customer experiences. This is challenging certain legacy luxury brands and will determine their success or failure.

Another trend disrupting luxury brands' face and icons is streetwear. Balenciaga serves as a perfect example: once an haute couture-oriented brand, the player regained consensus after several years of decline thanks to its brave shift towards streetwear, which has revolutionised (and "de-naturalised") the image of the brand itself, whose positioning has shifted from heritage-led brand to forward-looking streetwear. It is not surprising that the worldwide success of streetwear is completely reshaping the face of the whole luxury industry. Brands like Off-White, Supreme and Stüssy are considered "luxury brands of the future" and legacy luxury players have already started to collaborate with these new peers to stay relevant (e.g., Off-White x Louis Vuitton) or adapt their collections to this new wave by hiring sector visionaries (e.g., Virgil Abloh, founder of Off-White, was hired as Creative Director at Louis Vuitton).

Sustainability has become a must-have for every company rather than just a marketing tool for fashion brands. The increased awareness of luxury shoppers for ethical supply chain and sourcing has driven brands towards greener options compared to mass suppliers to keep margins high. Furthermore, also the tremendous growth of the resale market stands as a healthy signal for increased sensibility towards sustainability. Although it is not depicted yet as one of the major trends within the industry, it highlights that luxury consumers are making their purchases in a more eco-conscious way.

Last, once wholesale-led, distribution within the luxury industry is now focusing on a DTC-oriented strategy, giving the possibility to luxury brands to (i) earn higher margins and (ii) take control of the customer relationship and brand image. Channels are now considered as important touchpoint ecosystems, which are entrusted with the task of fostering and maintaining loyalty with shoppers.

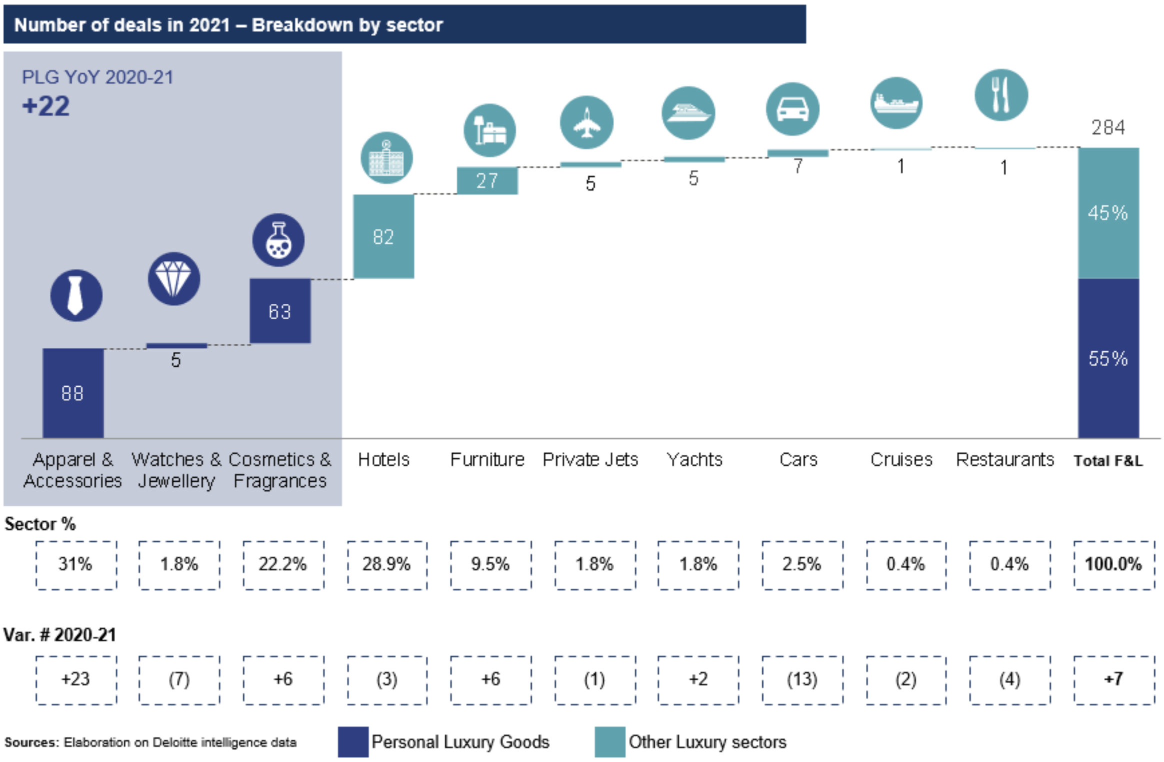
In an environment constantly evolving, luxury brands need to re-invest time and focus to understand the underlying psychological processes behind the reasons for shoppers purchasing luxury items and innovate accordingly to avoid remaining outdated and loosing competitive advantage.

2. The M&A market in the luxury industry

In an industry where scale is a must-have to stay relevant and maintain competitive advantage, M&A is an increasingly popular tool to pursue this goal.

In fact, if one wants to build up and manage brands on a global scale, maintaining constant product modernisation and innovation, leveraging marketing levers to stay relevant with every stakeholder - from consumers to suppliers – size cannot be neglected. The bigger the dimensions, the more synergies there are to improve and integrate competencies at different levels, from creative processes to business and operational parts of a company.

In 2021, the industry has proven to be a rich target for M&A transactions, seeing a modest increase in #deals (284) vis-à-vis 277 transactions in 2020, with Personal Luxury Goods sub-market (+22%) accounting for more than half of all deals.



2.1. The buyers and the sellers

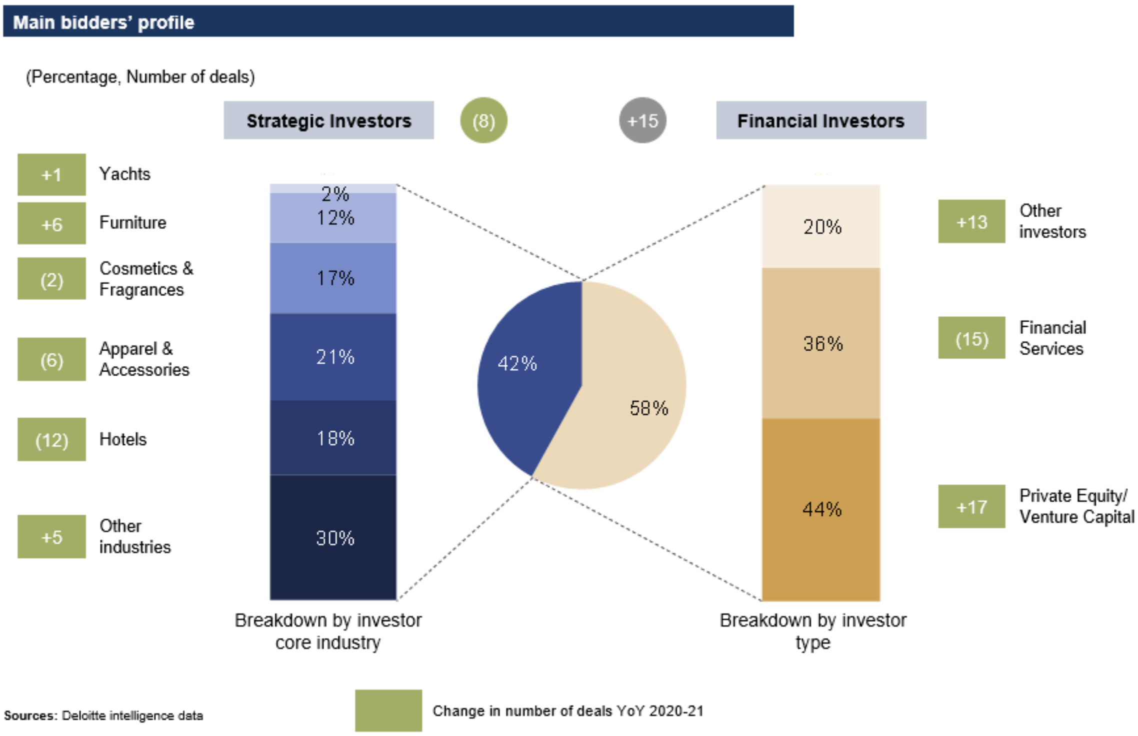
When analysing the luxury market, one has to know who the buyers and sellers are in order to understand the rationale behind the consolidation and the deals happening in the industry.

Looking at the buy-side, one can identify three different categories, whose rationales and motivations are very different: (i) luxury conglomerates, (ii) smaller but significant luxury brands and (iii) private equity firms. In other terms, the first two categories can be labelled as "strategic investors", in contrast with the latter which is usually categorised as a financial investor. This wide family also includes other financial players such as family offices and pension funds, whose presence on the market is, however, limited.

For luxury conglomerates (e.g. LVMH, Kering, Richemont), acquisitions should fall within the scope of their core business (i.e. personal luxury goods) and, at the same time, they should be able to have an impact on a group-level strategy and positioning.

The second type of players working from the buy-side is represented by those companies with a good financial and operational performance, willing to pursue further paths to growth, including the inorganic one. Furthermore, they usually want to pursue this goal without overstretching their core brands but rather by adding complimentary brands to their original portfolio. Some examples to be traced back are Moncler - Stone Island, Zegna - Thom Browne, OTB - Jil Sander.

Lastly, but with an increasing presence within the luxury space, there are private equity firms. These players have a shorter investment horizon and, given the absence of synergies, usually offer lower multiples vis-à-vis strategic investors. Given the objectives of these actors are completely different from those of strategic investors, targets for private equity firms also include companies needing financial support or a relevant turnaround: often, given the substantial capital inflow following an acquisition by a private equity firm, distressed firms look for it directly in order to sustain the business. On the other hand, financial sponsors may be very helpful to accelerate the growth of smaller companies or brands which are not interesting targets yet for strategic players due to minimum size thresholds.



Analysing the profile of investors during 2021, one can appreciate that most deals were completed by financial investors (58% on total #deals), of which Private Equity and Venture Capital funds represent the biggest share (44%). On the other hand, one can see that the largest part (38%) of deals done by strategics investors have happened within the Personal Luxury Goods segment, even if in absolute terms (#deals)

Looking at the sell-side, we can identify two different categories of companies, according to the reason for which their owners want to dispose (part of) the business: (i) owners who want to sell and (ii) businesses that need new capital / new buyer to survive.

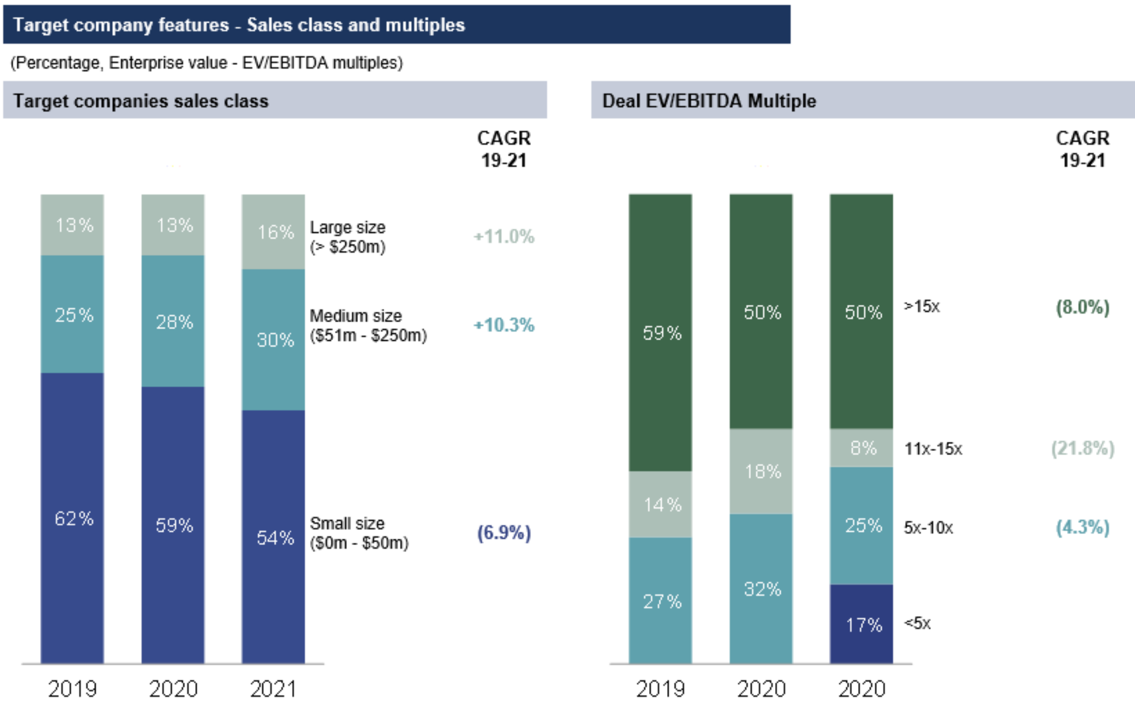
Just for the sake of theoretical reasoning, should a legacy and renowned brand like Armani, Patek Philippe or Chanel ever want to sell, this class of companies (belonging to the first category analysed before, i.e. owners who want to sell) would represent a once-in-a-lifetime opportunity for every type of buyers, especially the luxury conglomerates like LVMH, Kering or Richemont. Similarly, should Mayhoola decide to sell Valentino, it would be the seller to decide the rules of the game, given the exclusivity of what is often called "trophy asset" – usually carrying a significant premium to the market valuation.

Second, there are other companies which are not experiencing any financial trouble but see an integration within a larger group as an opportunity to grow faster thanks to access to extensive knowledge, competences and capital. On the other hand, this kind of companies may be exposed to generational changes and a disposal could be the only viable way to solve internal governance conflicts or refresh brand identity.

For instance, Stone Island used to be an highly-profitable standalone company but, when the opportunity to integrate with Moncler showed up, this proved to be too good to renounce for the sake of independence thanks to potential high brand synergies and the possibility for Stone Island to growth and scale its business up.

Then, there are companies looking for a buyer because the business itself is needing for something only a new investor can provide, ranging from new capital through a financial injection to the need of specific competences and knowledge from a strategic/ industrial partner.

Analysing the profile of sellers and, specifically, their sales class and multiples, one could appreciate that in 2021 the average size of targeted companies increased. On the other hand, investors continue to favour the lower band ($0-$51m Net Sales), still accounting for more than half of deals during the year. The decrease in relative terms of lower-sized firms has not been driven by a colder interest of investors towards smaller companies but rather by an attractive environment of interest rates which favoured growth from financing, also boosted by new actors such as credit funds. On the other hand, bigger players with already



Sources: Elaboration on Deloitte intelligence data
Note: The target sales class has been calculated for all companies with financial data which is publicly available

significant balance sheet have not found easy to raise more capital on the debt market and – when looking for additional capital – they have looked at the equity market. Analysing the multiple profile, transactions involving EV/EBITDA multiples greater than 15x remained constant in relative terms vis-à-vis 2020 while the medium range (5-10x and 11-15x) dropped significantly. Simultaneously, transactions with EBITDA multiples <5x reappeared (15% of all transactions).

Needs of players, both from the sell-side and the buy-side, are very diverse and make M&A deals happen in different ways according to what the parties are looking for from it, should it be financial support or the desire to belong to a broad conglomerate in order to exploit new competencies and synergies.

2.2. The role of strategic players

When analysing the dynamics and the rationales behind conglomerates - which is the ultimate goal of this research - looking at the buy-side is more useful than looking at the sell-side, which just acts as a target and does not have a voice in defining the post-transaction strategy of the conglomerate.

In particular, most of aggregators are strategic investors, industrial players willing to create large platforms of companies to exploit synergies across several aspects, from financial to tax or business areas.

However, the role of strategic players within the M&A market is not limited to the creation of large platforms. There are other ways to share competencies and creative ideas without an invasive integration such as an acquisition or a merger: joint ventures.

2.2.1. Luxury conglomerates

Small, independent and family-run maisons have been the main players operating in the luxury industry for most of its history: the *heritage* and *niche* attributes have always been fundamental values for the players to stand out, along with a true "exclusivity" dictated not only by high prices, but also by limited offering due to size limitations of the maisons themselves.

However, during the late twentieth and twenty-first centuries, the emergence of some dominant brands, capable to consolidate within their home market and expand abroad, has led to the creation of multinational luxury conglomerates. By 2019, more than half of global sales originated by the 100 biggest luxury goods companies worldwide was attributable to the ten biggest luxury firms. In terms of volume, the three biggest conglomerates are based in Europe, unanimously considered as the cradle of luxury: LVMH and Kering in France, Richemont in Switzerland. Moreover, contrarily to the American polarization happening in many industries, Europe's hegemony and weight is increasingly relevant and does not seem to abate. The recent acquisition of the luxury jewellery firm Tiffany & Co., one of the only and most prominent luxury American players, from LVMH stands as an example of how ambitious and competitive European luxury conglomerates are.

Rationale and benefits from consolidation

We have mentioned that, almost one century ago, incumbent luxury brands started the process which has driven to the creation of giant players now controlling the industry. However, it is interesting to understand why companies operating in different sub-markets within the luxury industry (i.e. same high-end positioning) have decided to merge and give life to what conglomerates are now.

First, we shall remember that – while it is possible that both parties of an M&A transaction are willing to undertake a consolidation journey together – usually there is a buyer to outline a certain strategy aimed at a creation of a platform carrying synergies from the combination of several companies, while the seller is looking at more precise goals from the deal, such as access to capital to increase in scale, expand its footprint and penetrate new markets (international or adjacent). Indeed, the track-record of the M&A market in the industry can confirm that every time a new exciting brand emerged, the player generally had a choice between two options – to stay niche and trivial in size or to be acquired by a larger luxury player and exploit the latter's assets to scale up its own operations.

On the other hand, also the acquirer may get specific benefits from an acquisition of a specific target: the former may be indeed in need of a rejuvenation, an increase in relevance or an enhancement of its image through new brands, were they emerging experimental players or iconic and more established brands, or a radical change in strategy (e.g. skiwear maker Moncler abandoning its single-brand strategy by acquiring its rival, i.e. men apparel brand Stone Island).

As a result, the typical targets for a conglomerate will be those brands with a strong positioning like Bulgari, Loro Piana or Off-White, rather than those players who need a financial turnaround before starting to produce value for the conglomerate.

Assessing the benefits from the point of view of the resulting entity itself (i.e. the conglomerate) is even more interesting and the luxury industry stands as a perfect example of how players can benefit from being part of a group. Amongst others, economies of scale, centralization of capabilities (e.g. higher purchasing power, shared technology and R&D efforts, group-level advertising), access to exclusive suppliers, capital and talent network, are the main synergies generating value in the context of consolidation.

On the other hand, also what seems optimal must be done with particular attention, from deal execution to actual consolidation of brands. When embarking the consolidation path, brands will necessarily face several inevitable challenges while trying to integrate key aspects of the companies, which could perfectly fit together or – on the contrary – could require an important alignment activity.

In particular, new platforms of several different brands have to put particular emphasis and attention when transmitting the integrated, group-level brand proposition: it is important for the firm leading the consolidation process to not jeopardise the founding values such as integrity, authenticity and prestige of the original brands when purchasing new ones. It is key, and one should ponder it with attention before integrating any entity distant from the original strategy and which requires relevant work to be done, to evaluate the balance between synergies and growth vis-à-vis integrity of existing brands. Similarly, on the corporate level, there will be inevitable challenges when integrating different cultures, value systems and fashion principles.

Consolidation often represents the best option for the healthy growth of luxury businesses, ranging from small and niche ones to consolidated brands looking at new options. Furthermore, consolidation carried on by strategic players is often without opportunistic motives, frequently characterising transactions pursued by financial sponsors. At the same time, some challenges and risks need to be taken in consideration and some reflections about the trade-off between growth and brand integrity must be carried out.

Consolidation trends

When luxury brands are looking for consolidation to pursue synergies, they often do it because of new needs or competencies they cannot develop internally. On the other hand, these new required capabilities and assets may be eventually grown in-house, but with a high price and long timing, crucial when new trends emerge in order to stay competitive: then, inorganic growth springs into action.

Nowadays, with new consumer trends, behaviours and an altered psychology behind their decisions, luxury players need to adapt quickly: organic work is often not sufficient and external one represents the easiest way to keep pace. Furthermore, besides customers, other drivers are responsible for the consolidation within the industry: in an increasingly crowded space, the control across the value chain is key for brands to keep margins high and to ensure high-quality supply of scarce high-quality resources.

Whether it is from the beginning with suppliers or from the end with customers, luxury players are trying to gain competitive advantage across the whole value chain and consolidation it the faster path to pursue this goal. Specifically, I have identified six major trends driving for consolidation within the luxury industry:

(i) Upward integration of brands to control the supply chain
(ii) Downward integration (e.g. franchisees)
(iii) Development of digital competencies to keep up with new young consumers
(iv) Need for extensive distribution network and significant infrastructure
(v) Sub-markets diversification for conglomerates
(vi) Globalisation with increasing relevant role of Chinese and Asian consumers

Focusing on the most interesting ones, upward integration is not new, but recent increases in prices of prestige, rare and expensive materials have caused an increased sense of urgency in safeguarding supply, with brands such as Prada and Chanel now completely focusing their inorganic growth strategy on it.

Specifically, farms of Merino sheep, cashmere, crocodile, alligator and python are increasingly targeted by incumbent players willing not to lose any competitive advantage. According to Mario Ortelli, head of the luxury industry at Sanford C. Bernstein, vertical integration gives the safety to source precious and limited-in-quantity materials and, at the same time, provides the artisanal expertise of working with rare products. This represents a relevant competitive advantage, and it also works as a marketing lever to gather the attention of customers caring about the uniqueness and superior quality of products. In fact, while vertical integration serves the aim of boosting bottom line, it also helps to improve brand's image to an increasingly aware customer base with regards to sustainability: the possibility to track where materials come from and the capability to prove an ethic supply is key to keep customers loyal and to be aligned with their requests. Vertical integration is indeed the only way to keep some businesses alive in a market where ESG is one of the key requirements: taking into consideration the example of Kering's acquisition of several python farms in Thailand, vertical integration has given the possibility to the conglomerate to show transparency about the supply process (e.g. farming of non-endangered python species) in a segment (i.e. exotic skins) where transparency is hard to find.

Another trend driving brands to look for other which have already developed internally some competencies is the digitalisation of customers. As discussed in section 1.3. The Luxury Consumers, the vast majority of luxury purchasers are now Millennials or Gen Z, digital natives who demand an integration of the legacy prestige-focused experience with their personalised and technology-enhanced shopping habits. Furthermore, the success of luxury digital shopping platforms has driven incumbent players to look for consolidation within this space (e.g. Yoox – Net-A-Porter, Farfetch – Stadium Goods) and financial sponsors to boost valuations (e.g. MyTheresa IPO). Moreover, also traditional luxury brands are now looking to collaborate with these digital giants: at the beginning of August, Florentine fashion house Salvatore Ferragamo has announced its intention to team up with Farfetch luxury platform to reinforce its omnichannel strategy, accelerating its digital capabilities and generating new engaging and disruptive shopping experiences leveraging Farfetch's Millenial and Gen Z global luxury audience.

A forced step for brands to stay competitive and healthy in today's luxury industry is potentiating the retail channel, which is the one guaranteeing a direct contact with consumers and the highest margins, while decreasing the relevance of the wholesale one. At the same time, a significant infrastructure is required to scale the business up at various levels of complexity, not only with respect to distribution. Consequently, opening stores abroad is no longer sufficient and, considering the period of stagnant growth suffered by the retail market, more and more incumbent labels are pursuing inorganic growth to exploit target's infrastructure for their own distribution (e.g. Michael Kors acquisition of Versace leading to the creation of a relatively small conglomerate named Capri Holdings). In other words, it could be convenient to a brand to buy market share rather than spending time and money trying to build it from scratch.

As conglomerates grow larger, they can take the risk (or the benefit) to look after luxury segments which are not directly linked to the ones they have started from. Many luxury buyers within the Personal and Luxury Goods space are now increasingly targeting experiential luxury brands and luxury players operating in design, homeware, wellness and hospitality, building up an expertise also in these segments. For instance, after its $3.2bn investment in Belmond, LVMH will be able to invest more and more in hospitality, becoming a reference player for the sector, with the possibility to further diversify in adjacent segments such as travelling services or fine dining. Also, smaller buyers are following LVMH examples too: it is enough to look within the Italian space, where Prada has acquired Marchesi after being beaten by LVMH in winning Cova. Diversification can happen within the same segment as well: as discussed in section 1.4. Upcoming trends for luxury players, changing preferences of customers towards fashion have driven luxury brands to redesign their collections and rethink their propositions, hiring sector visionaries by acquiring their brands (e.g. Off-White – LVMH).

Last, globalisation represents more a forced step to scale the business up worldwide rather than a current trend of the luxury industry. On the other hand, the possibility to expand far from the country where maisons have been established requires an effort which can be rarely completed independently, i.e. without the support of an entity already familiar with local consumers' preferences. Specifically, this is the case of expanding in the East regions, a mandatory path for incumbent players in order to have a global footprint and to catch highly spending luxury purchasers. However, the

retail expansion represents an extremely difficult step for small and newly established brands which lack of sufficient financial resources to pursue a roll-out of their physical channel in markets they are not familiar with. There are several solutions beyond a simple acquisition by a financial sponsor, which could provide enough capital to let the company increase its international presence autonomously. Within the M&A universe, a brand willing to expand abroad could look for a financial sponsor with proven experience in those markets of interest or with portfolio companies operating there: what Permira has accomplished with Dr. Martens and Valentino in terms of retail network expansion has been considered as a relevant credential from Golden Goose when it came the moment to choose a financial partner to potentiate the DOS infrastructure in Asia. While the previous option could be considered a temporary solution from the brand, given the limited investment horizon of private equity funds, should a brand decide to look for a permanent partner to develop several aspects of its business, including distribution, conglomerates are usually considered Tier1 amongst strategic investors: for instance, while all major conglomerates have now a global reach, Richemont is particularly rooted in the Asian market and could easily support small brands in their roll-out in Eastern markets. Last, a solution typically used by *still* independent companies is partnering with local distribution companies: however, this type of licensing eventually leads to margin erosion and does not represent a sustainable way to penetrate international markets, but rather a relatively fast possibility to increase brand awareness in new markets.

As examined, there exists many actions and initiatives that luxury brands need to pursue in order to survive the crowded and highly competitive market which is taking a very different shape compared to the one of a decade ago. The new luxury industry is digital, sustainable, global and integrated across the whole value chain: consolidation certainly represents one of the main options to stay competitive and up to date with current trends by sharing competencies and integrating infrastructures and networks.

2.2.2. Joint ventures and partnerships

As previously anticipated, another trend is emerging amongst luxury brands seeking alternative ways to M&A in order to innovate and learn from new and emerging players. In fact, joining a conglomerate or purchasing other brands is not always a viable option due to capital availability limits or refusal from investors to give away ownership rights. Joint ventures represent indeed a possibility for brands to share know-how, professional talents and ideas to come up with projects which could not be completed as standalone entities. In particular, joint ventures are popular when starting new lines not belonging to the original segment operated by one of the luxury brands. Design Holding ("DH") and Fendi joint venture named Fendi Casa stands as a perfect example of how – when an acquisition is not an option neither for the Investindustrial and Carlyle-backed design company nor for the LVMH-owned maison – two companies can share skills and capabilities from their core businesses to access new markets, i.e. partnering with a pre-eminent and legacy luxury brand is useful for DH to strengthen its portfolio brands' positioning as high-end to attract high-spending luxury consumers; leveraging DH renowned reputation as quality homeware manufacturer is certainly aligned to Fendi brand proposition.

While joint ventures represent a less invasive path compared to M&A, they still do not preserve independence: when a joint venture is established, a new business entity is created among two or more parties who share ownership, returns, risks and governance. On the other hand, two brands could pursue the same goals of joint ventures (e.g., access new market; gain scale efficiencies by combining assets and operations; share risk for major investments or projects; access skills and capabilities) through a less invasive route: partnerships. Gucci x Balenciaga, Gucci x Adidas, Louis Vuitton x Off-White, Rimowa x Off-White and Fendi x Versace (cf. Fendace) all stand for successful partnerships between luxury brands belonging to the same sub-market or different ones and aiming to innovate or rejuvenate brand propositions. However, compared to joint ventures, the creation of a partnership does not involve as many formal and legal fulfilments as required by the establishment of a joint venture which, again, is a separated entity – different from the ones founding it.

2.3. The role of financial sponsors

Beyond luxury players pursuing acquisitions in their own market for the reasons analysed above, other actors are increasingly looking at this industry: financial sponsors. This broad class of investors includes several players ready to commit capital they raise from likewise differentiated individuals and institutions. Amongst other, the most relevant investors active in the market are private equity and venture capital funds, family offices, pension funds and investment funds.

The luxury industry is particularly attractive to these categories because of several attributes and trends usually assessed from the financial investors when choosing where to deploy their capital:

(i) Intangible assets as an entry barrier and competitive advantage vis-à-vis existing peers and new entrants

(ii) Strong power of brand positioning leading to high profitability margins

(iii) Omnichannel distribution model with access to wide doors network and digital infrastructure

(iv) Unique identity and model of brands operating in the industry thanks to products produced and consumed for social distinction

(v) Growing customer base, especially thanks to the increasing relevance of the Chinese middle class

(vi) Strong pricing power and sourcing proximity (mostly Italy and France) leading to limited risk of supply chain disruption

(vii) Attractive trends characterising the post-pandemic recovery: wellness & comfort, aware consumption, green ethics & sustainability

(viii) Solid structural growth of the industry, both in terms of financial figures and stock market

As one could understand from the abovementioned requisites, for this category of actors, the motivations for purchasing a luxury brand are very different from the ones of strategic investors. If, for luxury players pursuing an investment, the importance and relevance of an acquisition is related to numerous strategic, brand and image motivations beyond only obtaining positive economic effects, financial sponsors mostly care about increasing the value of their investment. For this category of players, though, the goal is only that of investor satisfaction and thus many brands are viewed solely as assets whose value has to be revalued. Therefore, while the success for strategic players is defined as an effective integration between brands and companies able to create synergies, for financial sponsors the investment is successful only when the owners are able to sell the asset at a higher ticket.

Valentino certainly represents one of the most relevant examples of preeminent luxury brands being targeted by different categories of financial sponsors. In fact, the iconic Italian fashion house was acquired in 2012 by Mayhoola for Investments, an investment vehicle backed from the Qatar royal family with previous experience within the luxury industry with its investment in Balmain and in other various business areas such as financial markets, real estate, hotels & resorts. The vehicle acquired the Italian fashion house from another financial sponsor, i.e. private equity Permira, which boasts a long track-record within consumer goods and which has recently invested in luxury shoe brand Golden Goose Deluxe Brand.

2.3.1. Private Equity

Amongst the wide universe of financial investors, private equity represents the most common category of players active in the luxury market.

On the other hand, because of the small number of luxury brands available for sale on the market (it would be hard to define "luxury" a market overcrowded by brands as it would counter the definition of luxury itself), there is no financial sponsor investing in luxury companies only yet. The majority of private equity looking at the sector has indeed a wider background as investor in the consumer goods universe, which is a far more diverse and bigger industry. Nonetheless, when a private equity fund approaches a luxury company, its track-record and credentials within the sector is certainly taken into consideration.

Below a diagram with selected PE actors and - for completeness - also other categories of financial sponsors, such as family offices, with relevant track record within the consumer goods and luxury industries.

Last, an interesting remark can be done regarding private equity players in the luxury industries. Despite the mere financial objectives set by the funds, these investors are not insensible to the tangible synergies coming from the consolidation within the industry. This has led to the development of a trend, which is however still in its early days, of consolidation within the portfolio of companies held by the funds themselves. Chinese investor Fosun Fashion, later renamed Lanvin Group, started by acquiring individual companies within the luxury space (e.g. Lanvin, Sergio Rossi) until its portfolio turned into a small conglomerate. In the Italian space, Style Capital and its focus on fashion & luxury brands may lead to the creation of a platform of Italian brands operating in this industry. The time will tell us what initial shareholders (i.e. the fund) will do with these newly created small conglomerate but, if the latter will not disaggregate after the private equity's exit, some steps will have been made for the creation of luxury platforms.

2.3.2. SPAC listing

While a traditional investment made by a financial sponsor usually takes the form of a (possibly leveraged) buy-out, there exist other routes for these investors to enter the shareholders capital of a company.

Even if the current market environment is facing a strong slowdown from post-pandemic highs, record levels in 2021 have led to the significant comeback of a used-to-be popular investment vehicle, which fell out of favour because of the high incidence of frauds and penny stock scams associated with it: Special Purpose Acquisition Company ("SPAC").

In the current market environment, which is far more regulated than a few years ago, SPACs are seen as a popular alternative to the lengthy and complex IPO process: in fact, SPAC listing offers to companies a faster route to list on the public market by getting acquired from the acquisition vehicle and, subsequently, merging with it. Even if this investment vehicle is not riskless, offering to players the possibility to list in a short time frame and gain access to capital also during times characterised by unstable market conditions limiting liquidity, has led to the resurgence of SPACs. Moreover, in addition to representing an alternative path vis-à-vis IPO, special purpose acquisition companies can be also considered an investment pursued by a private equity fund, however publicly regulated by the market, which provides the capital to the blank check company.

The most interesting and controversial part of investing in SPACs is the route which ends by selecting the target company for the eventual deal. For the market, when the entity has not purchased any company yet, investing in its shares (characterised by a stable price of, for instance, €10) is like investing in a blind box, where you have no idea what you are paying for and whether the surprise will be of your liking or not.

According to a survey carried out by Standard & Poor Global, in the first six months of 2021, 430 SPACs successfully completed their route to IPO, raising a total amount of more than $104 billion and reaching unseen levels in the market. Simultaneously, the fact that a large number of incumbent players across different industries are increasingly looking at SPACs to list will certainly fuel interest in this rediscovered model.

The fashion and luxury industry is no exception to this trend, with Ermenegildo Zegna listing on NYSE through an Investindustrial-backed acquisition company representing the forerunner of SPACs' interest in luxury brands. In the meantime, luxury behemoth Bernard Arnault started a collaboration with UniCredit former CEO Jean-Pierre Mustier to launch a special purpose acquisition vehicle on the Amsterdam public market to focus on investing in European firms. Furthermore, Mr. Arnault has also jumped into the Asian market through SPACs: L Catterton, LVMH-backed fund previously mentioned in *2.3.1. Private Equity*, launched L Catterton Asia Acquisition Corp, a blank check investment vehicle listed in the United States and focused on the consumer technology sector in the Asian market.

As explained above, SPACs have been added to the list of potential routes for companies to raise capital: while they represent a faster and less resource-consuming option vis-à-vis Initial Public Offerings, they still carry regulatory requisites characterising public markets. At the same time, they have increasingly become investment spin-offs to juggernauts' main businesses, letting them expand their investment portfolios across different geographies and industries vis-à-vis the first ones they have invested in. For the purpose of healthy growth of original business pillars, it is important to investigate whether these ventures will sustain and boost the growth of existing brands or help them expand into new segments.

Investing in SPACs at their launch stage is mostly about its overall outlined strategy and management team – usually composed of those luxury behemoths, executives and investors. Balancing their experience to determine the value of the company, once the acquisition has been completed, is crucial and adds to the relevance of these vehicles within the fashion and luxury industry.

3. Luxury conglomerates: who they are and who do not want to be one

After having analysed the categories of companies pursuing a consolidation journey and the rationale behind it, we should focus now on the conglomerates dominating the market, understanding their success and why – as we will see – they all come from the same region and they have similar backgrounds, providing them some sort of competitive advantage.

3.1. The incumbents above Alps

Despite the presence of some luxury conglomerates worldwide, it is indisputable that LVMH, Kering and Richemont are the Tier-1 luxury groups within the industry. Even if there exist other conglomerates across the world, these certainly cannot compete with the ones just mentioned.

The dominant role of French brands certainly has to do with cultural and historical reasons: as addressed in the introduction to this paper, Europe is unanimously considered the cradle of luxury and, specifically, France is one of its main representatives. However, the inception of luxury made-in-France can only be traced back to the end of the 17th century during the reign of Louis XIV and his First Minister of State Jean-Baptiste Colbert. Before his kingdom, the French region was still distant from competing with Italy, China, and Holland, which were already world leaders within different fields of luxury, from porcelain and silk to lace and glassware. Finally, with the appointment Colbert in 1665, France took over the industry which would later become one of its main specialties and symbols: luxury. The regions of Gobelins, Saint-Gobain and Sèvres gathered the best-in-class craftsmen from all over Europe across the 17th and 18th centuries, developing unparalleled know-how and capabilities to export these symbols of wealth and richness across Europe. Therefore, it does not come with great surprise that a large amount of the greatest and most renowned luxury maisons were created in France.

With the advent of the 1830 July Revolution, the French middle class conquered its preeminent role in society and the personal luxury goods market effectively was born. The first relevant luxury brands made their appearance in the middle of the century: Hermès (1837) and Cartier (1847). With respect to the French luxury leather goods, the category started its rise in 1854 with the establishment of the first Vuitton workshop and laboratory, founded by the luggage-maker Louis Vuitton himself, raised in the Jura region. In the next century, it was the turn of

Longchamp, which firstly specialized in luxury leather goods and was founded in 1948 in the Maine et Loire and Mayenne regions.

Luxury has become an integral part of French history and culture, with the country progressively conquering its role across every luxury sub-sector. From jewellery to leather goods and fashion, France is now considered amongst the leaders of the industry, becoming a reference point for every player across the whole international scene.

3.1.1. LVMH Moët Hennessy Louis Vuitton

LVMH was created in 1987 through the merger of two companies (hence the acronym, obtained from the initials): Louis Vuitton, a company specializing in leather goods and fashion accessories and Moët Hennessy, a company focused on wines and spirits created in 1971. The idea to create a conglomerate of luxury brands belonging to different segments came to mind to the French investor Bernard Arnault, named president of the Group. Later, Arnault himself took control of the conglomerate due to deep disagreements occurred between the two sides. Supported by the investment bank Lazard, the French businessman implemented a governance structure capable of providing him the ability to control the Group with a 4% minority stake, broken down in 10 holding companies.

Born with the vision of becoming the largest platform of luxury consumer brands, LVMH was – since its inception – willing to expand its internationally by taking control of major Italian and American fashion brands. This strategy has resulted in the recent acquisition of mainly foreign brands: during the years 1999 and 2000 more than 25 brands are acquired. On the other hand, the transactions were soon carried out within a competitive environment caused by the entry of other consolidators within the luxury industry. For instance, one should remember the highly-disputed acquisition of Gucci with Pinault-Primtemps-Redoute (PPR) group (later renamed Kerin), which prevented LVMH from taking control of the Florentine Gucci group in March 1999.

Currently, the French conglomerate manages 75 luxury brands and operates across all five major segments of the luxury market: Fashion & Leather Goods (48% of 2021 revenues), Watches & Jewellery (14%), Perfumes & Cosmetics (10%), Wines & Spirits (9%) and Selective Retailing (19%).

The Group currently employs more than 175,000 people worldwide, with revenues of approx. €65B in 2021. Moreover, LVMH is the biggest public French company by capitalisation, controlled de-facto by the Arnault family with a 47.8% stake, held both directly and indirectly through Christian Dior SE. Furthemore, it should be noted that the Arnault family has full control of LVMH from a governance point of view, as it holds more than 63% of voting rights.

With respect to the acquisition strategy of LVMH, if one wanted to set a minimum size for a potential target to attract the conglomerate's attention, the former should account for at least $1B in sales. Moreover, other drivers characterise LVMH's investment approach: (i) vertical integration; (ii) investment in innovation; (iii) growth of its houses; (iii) balanced international portfolio. As one can appreciate, the conglomerate's activities are perfectly consistent with the consolidation trends examined in the *2.2.1. Luxury conglomerates* chapter, marking LVMH capability to identify and implement what the market and consumer require.

3.1.2. Kering

Founded in 1963, before LVMH inception, Kering was initially founded to pursue a completely different activity. In 1963, Francois Pinault opened the Établissements Pinault in Bretagne, specialising in wood trading. Thanks to its steep growth, the firm listed in 1988 on the Paris Stock Exchange and, the next year, purchased the 20% the France-based distribution company CFAO, active throughout the African continent, with which it merged in 1990. This transaction enabled the firm development within the retail industry. In 1991, Établissements Pinault acquired Conforama (French-based distributor of furniture merch), in 1992 Printemps

(Paris-based chain of department stores) and, lastly, Fnac (France-based retailer of books, electronics and multimedia) in 1994. In order to align the identity of the new platform of companies with the new activities pursued, the group changed its name in 1994 to Pinault-Printemps-Redoute ("PPR"). In 1999, PPR undertook its journey within the luxury industry by purchasing the 42% of Italian fashion house Gucci for $3B and the 100% of French maison Yves Saint Laurent. Since that time, PPR started a path of consolidation within the luxury industry, focusing on brands operating within the Couture & Leather Goods, Jewellery and Eyewear segments, to the point of selling those retail brands (i.e. Printemps (2006), Conforama (2011), CFAO and Fnac (2012) and, lastly, La Redoute (2013)) who boosted the conglomerates' growth during its early days.

In March 2013, accordingly with its new strategy, the group changed its name for the second time to Kering, recalling both the English word "caring" and the Breton word "kêr", meaning "home".

The group recorded an approx.€17B turnover for FY2021 and it employs almost 40,000 people. While its total sales almost come from three core brands (i.e. Gucci – 57%; Saint Laurent – 15%; Bottega Veneta – 9%), also from a product point of view the conglomerate is largely dependent on a small number of categories: Leather Goods account for the 50% of total sales, followed by Shoes (21%), Ready-to-Wear (15%), Watches and Jewellery (8%) and Others 6%).

With respect to the current acquisition strategy of Kering, its minimum threshold in terms of sales is likely lower compared to the one of LVMH, with an acceptable target company recording at least $500M in sales (vis-à-vis $1B for the Arnault-led conglomerate). This highlights that the group, compared to LVMH, is also looking for younger target companies.

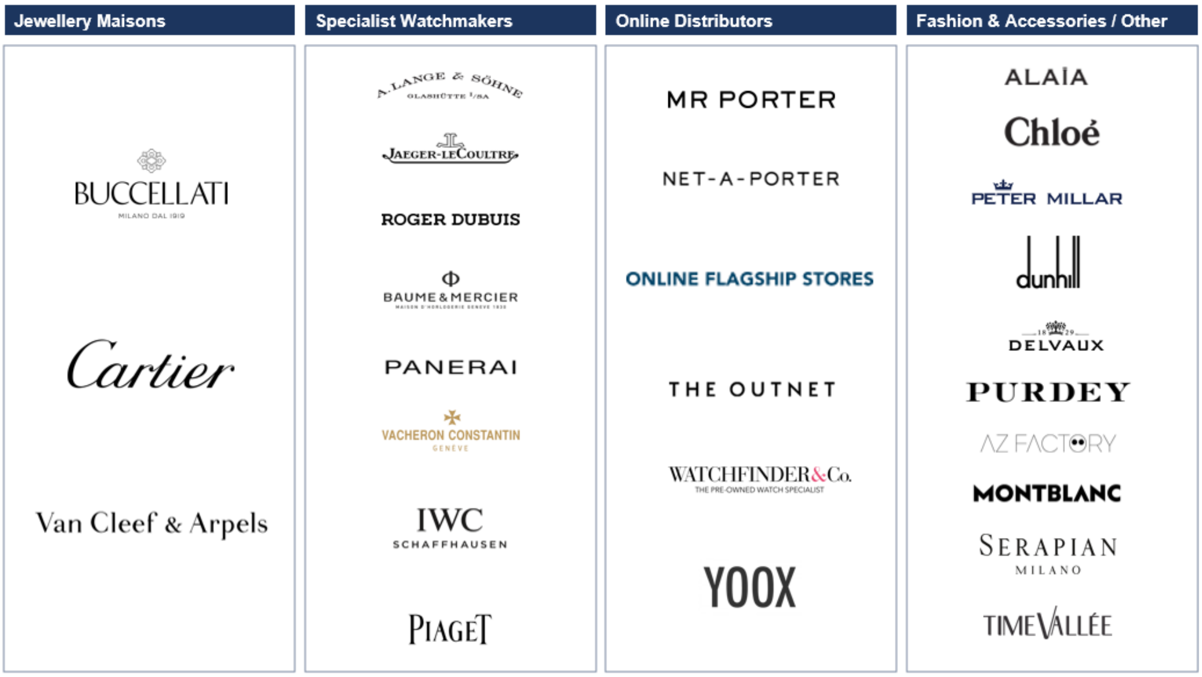
3.1.3. Compagnie Financière Richemont

The last Tier-1 conglomerate we are going to analyse is Compagnie Financière Richemont ("Richemont"), the only one not based in France but still born with the acquisition of a French brand.

The history of Richemont is linked to that of the Rupert family, its major promoters and financiers. Anton Rupert, a native of South Africa, was an entrepreneur as early as the 1940s in the tobacco and mining industries by owning Rembrandt Group. The approach and subsequent strategy of acquiring luxury maisons began in the 1970s, with progressive acquisitions of Cartier Monde, at a time when the French maison was going through an identity and governance problem. A new division within Rembrandt Group was created and named *Vendome*, managing Cartier Monde and Dunhill (controlled by Cartier Monde), which itself owned Montblanc and Chloé.

Johann Rupert, Anton's eldest son, is the continuer and finalizer of the acquisition and concentration strategy begun by his father: in 1988, Johann Rupert separated the mining and tobacco business from the luxury one, set Vendome's headquarters in Geneva, and became CEO of the group, renamed Richemont, a functionary word invented to fit with the core business. In 1999, Rupert bought 60% of the iconic jeweler Van Cleef & Arpels for $265M, and in 2002 he paid $1.86B for watch brands Jaeger-LeCoultre, IWC and A. Lange & Söhne.

Today, the group is a major player in the luxury world, whose product identity for the brands and maisons is mainly rooted in haute horology and jewellery rather than pure fashion. In fact, with 26 maisons and businesses, Richemont is diversified into four business areas: Jewellery Maisons (57% of total sales for FY22), Specialist Watchmakers (18%), Online Distributors (15%) and Fashion & Accessories / Other business (10%).



It should be noted that, differently from its competitors, Richemont has recently heavily invested in Online distributors, a growing segment within the luxury industry due to changing habits and preferences of consumers. On the other hand, the fashion segment is still marginal compared to the others, but it is gradually growing in importance within the group.

Richemont currently employs approx. 35,000 people and accounted for €19B revenues in FY2022. The conglomerate falls amongst the first ten firms by capitalisation on the Swiss Stock Exchange. Through a specific governance structure, As of March 31, 2022, the financial holding of the Rupert family (Compagnie Financière Rupert) is the only significant shareholder

(>3% voting rights), with 5.2M 'A' shares and 522M 'B' shares. Despite only representing 10% of the equity of Richemont, the Rupert family holds 51% of the Company's voting rights thanks to 'B' shares.

3.2. The Italian lag in producing a multi-billion luxury conglomerate

Notwithstanding a high incidence of billion-dollar luxury brands, Italy is still lagging behind France to create a luxury conglomerate such as LVMH or Kering, which currently own four preeminent and legacy Italian billion-euro luxury brands, mature and large enough to be considered amongst (or the) the "core" brands of the diversified platforms. Arnault-led LVMH owns Bulgari and Fendi; whereas Pinault-led Kering controls Florentine Gucci and Bottega Veneta. Therefore, it is very interesting to analyse and understand why such iconic Italian fashion brands have not yet managed to build a conglomerate of their own.

The reasons why Italy lacks a conglomerate of scale can be traced back easily and range from psychological to more prosaic ones.

Starting from business-related matters, the product categories addressed by luxury brands are a clear watershed. The French luxury players mainly focus on brand accessories, which allow brands to have a more diversified product portfolio. On the other hand, Italian fashion houses – known worldwide for their tailoring capabilities - are more concerned with ready-to-wear. The vast majority of accessories items are able to provide higher profitability margins (specifically, gross margin), allowing French luxury brands to conquer competitive advantage vis-à-vis Italian peers, which face higher COGS. This is one of the reasons why we frequently find luxury conglomerates expanding their core offering towards home décor, beauty, fragrances and other categories: while Italian brands are more reluctant to expand in other categories than their original ones, French luxury brands are capable to range from luxury luggage, accessories, bags and footwear to wines and premium liquors, exploiting cross-selling opportunities. The variety of offerings also provides the French brands a useful business approach of managing large and diverse product portfolios, delivering relevant competitive advantage in terms of readiness and adaptability to create and build up a conglomerate rather than a single-brand company.

Second, moving to more psychological and mental motives behind the lack of luxury conglomerates, Italian luxury companies are relatively younger compared to French ones: most of them were founded after World War II, the majority after 1975. Therefore, many brands are still founder- or family- led, with founders and founding families usually found to be less open-minded towards integration into a larger platform vis-à-vis legacy brands which have seen many changes in ownership throughout their history. Instead, brands which are still led by founders or close family are now increasingly preferring to look for purely financial partners (e.g. private equity) in order to gather additional capital for the company's development or to monetise part of their efforts – on the other hand, many still look at independence as a fundamental requirement. To make some examples, Dolce & Gabbana and Armani represent two of Italian billion-euro luxury brands which are still private and seem not interested to look for any partner, nor strategic nor financial. Missoni and Etro, on the other hand, are smaller but established founder- / family-led luxury brands which have recently looked for support from financial sponsors to scale the business up but whose families are not willing to give up all ownership and rights as it would require joining a large platform such as LVMH: this is the reason why Etro has sold a majority stake to LVMH-backed private equity L Catterton and not by LVMH itself. Although the transaction involves the disposal of more than half of the capital, the possibility for the founder and the family to hold relevant roles in the company (founder Gerolamo Etro has been nominated President of the firm after the transaction) would have not been guaranteed if the Italian brand had been acquired by a large conglomerate such the Arnault-led one.

Last, one should take into consideration that Italians working within the fashion field typically have a different school of thought vis-à-vis their cousins beyond the Alps: first, the word "luxury" is rarely used to define their product as they prefer not to appear as inaccessible or prohibitive products to customers. Instead, they would want their product to be known and perceived as items of great excellence, with very high quality or with factual innovative content. Second, the growth strategies for some of the most preeminent Italian luxury brands (e.g.

Armani, Dolce & Gabbana, Ermenegildo Zegna, Salvatore Ferragamo) do not envisage the plan to become an Italian conglomerate by acquiring other brands. Even Prada, which went through an unsuccessful inorganic growth strategy and ended to dispose some of the acquired brands (e.g. Fendi), now it is mainly focused on vertical integration and on its remaining portfolio: Miu Miu and shoemaker Church's. It is common a thought amongst Italian luxury billion-euro companies that the goal for them is not to become the biggest conglomerate and to compete with French ones, but to be the coolest brand on the street, dictating the trends and becoming a point of reference for the whole fashion industry.

In addition to the above-mentioned reasons - which involve several aspects of Italian brands themselves, from psychological to business ones - one should consider that the increasing presence of financial sponsors within the luxury space also affects the possibility for any aspiring Italian brands to act as an aggregator, as they must compete with private equity funds.

For instance, The Carlyle Group has a long track-record in the luxury space: the private equity sold its stake at 6x value vis-à-vis their initial investment when Moncler went public. Mayhoola's buyout of Valentino from Permira happened during a phase of steep growth for the Roman maison, with sales increasing from \$230 million (2009) to \$700 million (2014), reaching almost \$1.3 billion in 2021. As reported above, also smaller brands are being targeted by funds (e.g. Missoni, Etro).

Amongst the Italian luxury space, it is certainly felt the absence of an Italian consolidator of a relevant scale, which would offer some kind of protection from the French players and financial sponsors.

3.2.1. The Italian runners-up

Despite the fatigue of Italian luxury players in establishing their role as industry consolidators, some candidates are gradually emerging, outlining a preliminary strategy for inorganic growth. Amongst these few players, we can distinguish two categories by nature:

strategic players and financial sponsors with specific capabilities and experience in the luxury space.

First, strategic players represent the natural option for a company to become a conglomerate of brands, as they would start their potential consolidation journey equipped with a working corporate structure and with experience in business- / operations-related matters necessary for a company to operate properly. As a result, strategic players acting as consolidators could be seen as companies scaling their business up by widening their brand portfolio. Then, in order to make this process credible and feasible, a firm starting a consolidation path must have a mature and scalable structure and a genuine intention to develop the acquired brands along with the original ones, without only exploiting the new ones in favour of the original ones.

Amongst the Italian luxury brands, the credible candidates to start such a challenging route are very limited in number.

OTB, an Italian fashion group founded by Renzo Rosso in 2002 as a holding company for Diesel and future brands' acquisitions, represents the only attempt amongst billion-euro luxury companies to act as a market aggregator. The Group, whose name stands for Only The Brave and whose revenues accounted for approx. €1.5B in 2021, controls the Italian and international fashion brands Diesel, Maison Margiela, Marni, Viktor&Rolf and Jil Sander. Moreover, it holds a minority stake in the American brand Amiri and controls the companies Brave Kid and Staff International (manufacturer of garments for Just Cavalli and Marc Jacobs and Just). In addition to its current portfolio, the rumoured interest in AEFFE (Italian luxury group owning Alberta Ferretti, Moschino and Philosophy brands) and the intention to list on the Milan Stock Exchange in 2024 strengthen the credibility of OTB to compete with larger French groups.

Amongst the panel of selected candidates, Moncler represents the second potential aggregator of the Italian luxury system. The skiwear & fashion Italian company of French origin was founded in mid 50s in France and used to manufacture technical equipment for skiers. Only after few years after its foundation, the first quilted jacket were produced for the factory workers and, after an alpinist made remarks on them, a line is commercialised to customers.

Moncler’s peak is achieved in 1968, when the brand became the official supplier of the French national Alpine skiing team during the Olympic Winter Games in Grenoble. In the 90s the brand goes through several changes of ownership, ending up in being acquired by Remo Ruffini, current main shareholder and CEO, in 2003. From 2003 to 2013, when the luxury firm goes public on Milan Stock Exchange, the brand is targeted by different private equity funds (i.e. Eurazeo, The Carlyle Group) which later partially divest their position with huge profits. After other financial sponsors (e.g. BlackRock, Temasek) enter the firm’s capital, highlighting the interest towards in a highly profitable and growing luxury company, Moncler starts its M&A campaign, which supports its claim towards becoming a luxury platform in Italy. The acquisition of Stone Island for €1.15B in 2021, a transformative deal for both brands, has prepared Moncler for its next stage of growth as an Italian luxury aggregator, opening for Moncler's 'Chapter 2'. Nonetheless, the transaction has been functional to also boost the opportunity for organic growth enjoyed by the two luxury brands. On the other hand, Ruffini himself has demonstrated to be quite skeptical about the aggregation of Italian luxury brands to create a national champion: one year after the acquisition of Stone Island, the group CEO has stated that the transaction happened in an “accidental” way, inspired by a casual meeting of his son and the one of Stone Island’s owner Rivetti. According to his words, the acquisition has certainly worked very well because of a strong cultural and brand fit but was not aimed at the creation of an Italian luxury conglomerate. In fact, Ruffini said that he does not expect consolidation to happen in the Italian fashion market, mostly due to a deep history of family entrepreneurship and profound involvement in the business of the family members themselves. “In Italy everyone wants to hold a majority [stake] […] [as] most companies have a long history […] [of several] generations [involved] and it’s hard to let go” he added. “It’s [an] Italian cultural [motive]”. On the other hand, he confessed that he has never been too worried about stakes and that he has never feared giving up ownership in the company, was this done for the good of the brand.

If finding a candidate for the creation of a luxury conglomerate amongst strategic players is as challenging as the consolidation process itself, if one were to look at the financial sponsors’ universe it would be even more difficult. The opportunistic logic of buying and selling later at a higher value locks indeed up the luxury system: instead of making part of a larger platform of brands, many luxury firms are stuck within private equity portfolios pending an increase in their value to be sold (again) at the best offeror. Certainly, a luxury conglomerate would be a fine meal for a financial sponsor but building it up from the ground would require a large number of capabilities and knowledge. Then, despite the potential stellar return from a consolidation pursued by a financial sponsor leading the process, often it is considerably easier to just buy and sell individual brands. However, some actors are understanding the assignment and trying to fill the gap left by strategic players.

Exor, a Dutch financial holding company controlled by the Italian Agnelli family with a Net Asset Value (NAV) around €27B, is increasingly considered a realistic candidate to pursue a consolidation of luxury brands across the country. To understand its claims, one should look at its portfolio: in addition to soccer club Juventus and the automotive group Stellantis, Exor's major investments also include the capital good company CNH Industrial, the industrial group Iveco and the luxury car manufacturer Ferrari. On the heels of the participation in Ferrari and of the widely renowned allure of Agnelli family, Exor has increasingly looked at investments within the luxury space. In December 2020, the holding company announced an investment of about €80M in the Chinese luxury group Shang Xia, in which it became the first shareholder along with Hermès International. In an interview with La Stampa, John Elkann said that Exor aims to develop, along with Hermès, a large Chinese luxury reality. A few months later, at the beginning of 2021, the financial holding purchased a minority stake (24%) of French fashion maison Christian Louboutin by investing approx. €541M.

The entrance of Ferrari within fashion through the launch of its own collection has made many ask themselves about the potential of Exor in becoming the next Italian luxury consolidator. Amongst the ones pondering this question, Giorgio Armani has been rumoured to have talked with John Elkann. The Agnelli heir and the 88-year-old Italian designer have been said to have explored tie up with Ferrari as a feasible investment vehicle to drive consolidation, anchoring the conglomerate around the luxury carmaker. Elkann has probably offered Armani to purchase a minority stake in the Italian fashion house, but the proposal was probably rebuffed due to designer’s reluctance to sell. Nonetheless, even though Exor-Armani transaction will probably never see the light, this has certainly shown up Agnelli’s concrete intention to enter the fashion industry and become the Italian Arnaults. Many are convinced that the Agnelli / Elkann family is the only one able to build up a serious rival to French conglomerates: they have money, credibility and family prestige to pursue this journey.

That said, the delay in building up a luxury conglomerate has now become significant, with scales such as those of LVMH and Kering looking difficult to be ever reached by a new rival. Furthermore, in a market context where French players seem to be invincible in terms of financial and business capabilities, the disparity in scale between new potential conglomerates and French ones still let the formers exposed to the risk of being acquired, despite the intention to act as a consolidator and not as a target. In fact, this scale disparity does not only translate in different relevance in the market to the eyes of consumers, but also affects the possibility to act as a proper consolidator: such difference in scale leads to considerable gaps in acquisition firepower, reputation and consideration by sellers in the context of a highly competitive bidding process, which could easily end-up in favour of one of the incumbent luxury conglomerates. On the other hand, one should take in consideration that a different scale also entails different interests in targets with respect to size: for instance, French conglomerates may target brands with sales in the range of €500M-€1B, while Italian players typically look at smaller brands with sales around €200M-€300M.

3.2.2. Americans trying to be Italian: Capri Holdings case

While, due to psychological or business-specific reasons, Italian luxury companies are finding it harder to integrate within their strategic vision being part of / create a conglomerate (despite some exceptions), American ones are finding it easier and more straightforward. Therefore, by targeting Italian brands while pursuing consolidation, the chances for them to become an Italy-based luxury conglomerate are not negligible.

Capri Holdings, founded in 1981 by Micheal Kors, is a holding company owning Micheal Kors, Jimmy Choo and Versace brands. Formerly known as Micheal Kors Holdings Limited, it was renamed Capri Holdings in 2018, following Versace $2.1B acquisition. Capri, a fabled island located in front of the Sorrento Peninsula representing the Italian luxury lifestyle, was used as an inspiration to rename the group with the precise intention to undertake a consolidation journey in Italy, potentially becoming its first luxury consolidator. However, following COVID-19 pandemic and other macroeconomic challenges, the American conglomerate redefined its inorganic strategy toward the acquisition of luxury legacy brands across entire Europe.

Despite the strategy change, the acquisition of further Italian brands is not unlikely, given the high incidence of luxury brands in Italy if one were to consider the European ones. Were this the case, Capri Holdings may effectively become the first Italian conglomerate: this would represent a tremendous defeat for the Italian entrepreneurship.

3.3. The dissidents

Not every European luxury firm is part of a large conglomerate. Many amongst the universe of heritage luxury firms have remained private (e.g. Chanel, Armani, Dolce & Gabbana, Longchamp) and others have chosen different ways from consolidation to boost their growth, for instance by going public (e.g. Hermes, Brunello Cucinelli, Zegna).

One of the main reasons why these incumbent companies have chosen to stay out of a conglomerate can be traced back to their ownership structure: in each of the abovementioned companies, family members still retain controlling stakes in the companies. As a matter of fact, these multinational firms still deserve to be addressed as multigenerational/ family-owned businesses: this is certainly a factor adding an allure to brands who constantly strive to maintain their heritage image, but which involves different logics behind strategic moves, often driven by personal and emotional motives. "Belonging to a larger group is not a magic recipe that is going to guarantee success", affirms Jean Cassegrain, CEO of Longchamp, while confirming the intent to not sell the business despite the harsh competition: "our intention is to keep the company private and family [owned]. We like it this way, it's a personal family decision".

Furthermore, keeping large luxury firms private has recently been an important objective set by national government authorities, which have acted through extraordinary protective measures against unwanted approaches from foreign investors (strategic and, especially, financial). This government interventionism, often political, has become progressively frequent in the last decades: if this happens with regard to strategic assets such as infrastructure, defence or telecommunication companies, the importance of national brands has been now put under the spotlight also for luxury firms. In fact, a very important role is now assigned to the recognizability and prestige characterizing these companies and, in an increasingly nationalistic political and societal environment, also luxury firms have started to be considered strategic.

3.3.1. From listed conglomerate to private stand-alone brands: the TOD’S Group case

From time to time, a larger corporate structure may result in some inefficiencies coming from a poor focus on specific needs of each brand or from an improper centralisation of certain functions. While in some cases the inefficiencies may drive a conglomerate to temporarily arrest inorganic growth activities towards other brands but rather towards companies operating across the value chain (e.g. Prada’s investment in vertical integration after unsuccessful acquisitions of other brands), it also may be the case for a luxury conglomerate to opt for a separation – or, in technical terms, “spin-off” – of part (or all) of its portfolio brands.

An on-going transaction of this kind can be found within the Italian luxury space: TOD’S Group (“TOD’S”). The conglomerate controlled by Della Valle brothers have announced at the beginning of August its intention to delist the group, focused on luxury shoewear, from the Milan Stock Exchange and to start a valorisation process of its brands (i.e. TOD’S, Hogan, Fay, Roger Vivier). According to the press release on the day of the announcement, the Della Valle family has decided to "make a major investment in the company to accelerate its development" with the aim of enhancing the individual brands owned by the company, "giving them strong individual visibility and operational autonomy”.

The decision does not come as a surprise, with TOD’S financial performance increasingly distant from those of incumbent luxury players. The comparison had been merciless for some time now, and the value of the stock no longer held up to comparison with the real giants of luxury such as LVMH, Hermes or Hugo Boss, just to name some of the luxury peers with which analysts were comparing TOD'S performance. But the profitability comparison also saw TOD'S losing to that patrol of domestic stocks grouped in the luxury segment, e.g. Brunello Cucinelli, Prada, Moncler.

Until 2013, record-year for the Italian conglomerate whose share price touched €140 (before the tender offer, the share price was around €30), TOD'S was accustomed to seeing increasing rates of profitability with EBITDA margin topping 25%. However, 2013, the year of record-high stock levels, worked as a watershed: TOD'S has since put it in reverse gear. EBITDA margin began a dismal slowdown that has never recovered. In 2017 it had fallen to 15% and, as of today, it stands at 7%.

While TOD'S languished, others kept up the pace such that they deserved the premium valuations that the stock market recognizes for luxury stocks, by virtue of their high and consistent profitability. Brunello Cucinelli, for example, has an EBITDA margin of 16%, Ferragamo touches 19% and Moncler exceeds 30%. The gap gets even deeper with the European luxury giants, with Hermes above 40% and LVMH itself, which will hold a 10% stake in TOD'S after the delisting, around 30%.

By this time, the stock market had not, for years, recognized TOD'S the market multiples assigned to luxury stocks and the hope of Della Valle brothers is that, by valorising each brand and focusing on them individually, profitability will return to their old glory and investors will attribute luxury premium to them again.

3.4. The rising (target) stars

Amidst the consolidating universe of luxury brands, with leading firms growing their scale and their market share, a new phenomenon is feeding the luxury industry with new, young and independent brands: small "rising stars" brands - typically with revenues not above €200M - born from the birth and popularity of new values and consumption patterns, which are characterised by an unseen speed due to several exogenous factors such as the Covid-19 pandemic.

In 2021, rising stars accounted for approx. 2% of the whole luxury market and, because of some mouth-watering traits such as 2x growth vis-à-vis the broader market, they are reaching record-high valuations. This is due to the benefits that legacy larger groups or financial sponsors would derive from acquiring rising stars: their updated brand proposition and the capability to reach new customers would create considerable synergies with groups who are trying not to lose customers due to changing habits and needs.

4. What's next in Italy?

With Italian luxury brands increasingly targeted by foreign investors - strategic and financial - because of their competitive margins and their loyal customer base, the risk for international capital to seize the whole industry is getting tangible.

Nonetheless, the current market is more of a seller's than a buyer's one, with multiples still at record levels compared to peers with lower positionings, despite the adverse macroeconomic conditions at present. From the eyes of buyers, however, it still makes sense to invest in brands which can provide diversification to buyers' business(es) or fill a gap in their capabilities and competencies. Moreover, most buyers do not really think about the immediate few years but rather to the next decades in terms of value extraction from such deals: as a result, paying high multiples becomes relative when you are a long horizon view (e.g. 15 up to 20 years).

4.1. The difficulties of creating an Italian luxury champion…

The current composition of the market leaves little space for any brand to come up with its own vision for a new consolidated reality. Existing conglomerates have large budgets to fund their own M&A plans and every established single-brand company will find considerable difficulties to compete with them as they lack the same resources to be deployed in marketing and M&A opportunities. Consequently, even the ones trying to build up a consolidation plan could find so intense competition that they could end up being acquired themselves.

In addition to external competition complicating any realistic strategy, as discussed in *3.2. The Italian lag in producing a multi-billion luxury conglomerate* paragraph and how reported by Moncler's CEO, there exists several complications against building up a conglomerate guided by an Italian brand, because of psychological issues against giving up ownership and business-related drawbacks that do not permit undertaking such a challenging and demanding journey in terms of resources needed.

After the massive M&A wave happened in 2021, boosted by favourable conditions such as close-to-zero rates and almost interest-free debt, the trend is expected to continue despite rates being progressively pushed up by central banks to fight inflation. Existing conglomerates are still expected to be the first agents of consolidation and they are predicted to look mostly for big brands, as they can extract from them a larger amount of synergies and recover their financial investment in a shorter horizon. Synergies are clearly the driving force of consolidation for these large platforms: HR, digital, accounts, legal and logistics are considerable in volume and such relevance is increasingly recognised by conglomerates themselves when targeting a potential add-on: Pierre Godé, former vice-president of LVMH and long-lasting right hand of Bernard Arnault, has been assigned a new role to oversee synergies arising from Italian businesses controlled by the French group (e.g. Bulgari, Acqua di Parma, Fendi and Pucci, Loro Piana).

As a result, to extract the most synergies from the transactions lying ahead, the targets are projected to be of relevant size and also potential aggregators are in the French almighty sights.

4.2. …but the need for one to establish its own domain

The premises are not encouraging: the creation of an Italian consolidator seems quite unlikely in the current market environment. However, the importance of such a task is increasingly recognised by national brands and experts, which are starting to ask for someone to take steps towards this tough mission by remembering Italian players the several benefits arising from consolidation.

As discussed in *2.2.1. Luxury conglomerates* paragraph, conglomerates are born from the synergies arising from them, which can range across the whole value chain and all corporate functions. Moreover, changing customer needs and preferences are making consolidation the smoothest path for legacy brands to keep up with updated values and necessities. Integration has to be well-studied and weighted before providing results but, once correctly executed, it can ensure tangible advantages to both parties.

In addition to prosaic motives supporting consolidation, the psychological ones mentioned before may end up providing additional reasons to create an Italian rival to the ones above the Alps. While founding families are still involved in managing brands, creating obstacles in giving up stakes easily and entering into conglomerates, the same "pride" motive may easily translate into a "national pride" motive. The latter could effectively encourage some entrepreneurs in trying to acquire local brands before international actors do. If the contest is vis-à-vis French players, this could work even more efficiently.

Benefits are significant and some players have luckily started to look around to try to create an Italian luxury champion. The delay vis-à-vis French players is considerable and the challenge hard: only time will tell us whether the opportunity of consolidation will be seized by an Italian actor, were it a brand, a family or a fund, or the French competitors will make a clean sweep of the national luxury market. Certainly, this would be a huge loss for Italian entrepreneurship and pride.

References

Alexander Wei (2021). "What does the SPAC Frenzy Mean for the Fashion and Luxury Industry?". Luxury Society.

Alexander Wei (2021). "Chinese Luxury Investors: Hear Them Roar". Luxury Society.

Alfoso Segura (2019). "Luxury and Fashion Corporations". The Fashion Retailer.

Anna Cabigiosu (2020). Digitalisation in the Luxury Fashion Industry: Strategic Branding for Millennial Consumers. Palgrave Macmillan.

Annamma Joy (2022). The Future of Luxury Brands: Artification and Sustainability. De Gruyter.

Bain & Company, Altagamma (2021). Luxury Goods Worldwide Market Study, Fall 2021 – 20th Edition.

Boston Consulting Group, Altagamma (2021). True-Luxury Global Consumer Insights, 8th edition.

Compagnie Financière Richemont (2022). FY2022 Annual Results.

Crobox (2021). The State of Luxury - Luxury Consumer trends, segments, and the psychology behind their decisions.

Danielle Wightman-Stone (2022). "Salvatore Ferragamo announces strategic partnership with Farfetch". Fashion United.

Deloitte (2020). Global Powers of Luxury Goods: The New Age of Fashion and Luxury.

Franca Sozzani (2011). "Qual è il senso del lusso?". Vogue Italia.

George Arnett (2019). "Why private equity loves fashion". Vogue Business.

Georgina Safe (2017). "Luxury Brands Are Snapping Up Farms to Control their Supply Chains". Business of Fashion.

Giulia Segreti (2021). "Moncler CEO: I Don't See Consolidation in Italian Fashion Market". Business of Fashion.

Howard Wilmot (2021). "The changing face of the luxury consumer". Dialogue.

Jian DeLeon (2019). The New Luxury: Defining the Aspirational in the Age of Hype. Die Gestalten Verlag.

Julie Zerbo (2021). "LVMH: A Timeline Behind the Building of the World's Most Valuable Luxury Goods Conglomerate". The Fashion Law.

Julie Zerbo (2021). "Exor Says Luxury is Among 3 Sectors it Will Prioritize Going Forward". The Fashion Law.

Kati Chitrakorn (2021). "Behind Italy's luxury deal surge: Is a conglomerate next?". Vogue Business.

Kering (2022). 2021 Full-year results.

Lucy Maguire (2021). "The new investment fund scaling African luxury brands". Vogue Business.

LVMH (2022). 2021 Annual Report.

Maria Eugenia Giron (2011). Inside Luxury - The Growth and Future of the Luxury Goods Industry: A View from the Top. LID Publishing.

Mario Ortelli (2021). "Luxury M&A Opportunities Will Heat Up Post-COVID. Here's Why". Luxury Society.

McKinsey & Company, Business of Fashion (2022). The State of Fashion 2022.

Patrizio Bertelli (2012). "Prada's CEO on Staying Independent in a Consolidating Industry". Harvard Business Review.

Peter Frankopan (2015). The Silk Roads. Bloomsbury.

Pierre Xiao Lu (2021). International Luxury Brand Strategy. Routledge.

Pierre-Yves Donzé, Véronique Pouillard, Joanne Roberts (2020). The Oxford Handbook of Luxury Business. Oxford University Press.

Robert Williams (2022). "Diesel's Comeback Reignites Ambitions to Build an Italian Fashion Empire". Business of Fashion.

Robert Williams (2021). "What A New Wave of Italian M&A Means for Fashion". Business of Fashion.

Robin Mellery-Pratt (2015). "Why Isn't There an Italian LVMH?". Business of Fashion.

Selina Bucak, Lina Saigol (2019). " Tailor made or ill-suited? Private equity tries on luxury brands". Private Equity News.

Tamburi Investment Partners, Altagamma (2021). How Private Equity Can Support Luxury.

Tamison O’Connor (2018). “Longchamp's Plan to Stay Competitive Amid Luxury Consolidation”. Business of Fashion.

Valentina Za (2021). “Report: Giorgio Armani Could Consider Joint Venture Partner”. Business of Fashion.

<u>Stockholm School of Economics thesis</u>

"The non-effect of IFRS-16 accounting standard on the valuation of luxury companies"

Tutor: Gualtiero Azzalini

This research aims to meticulously examine the implications, or their absence, that stem from the adoption of the IFRS-16 accounting principle on the valuation of luxury fashion assets. Since the official endorsement of this accounting standard in 2019, the valuation practices for these assets have, for the most part, continued to be based on pre-IFRS-16 methodologies. This is predominantly due to the substantial impact that lease rentals have within the luxury fashion industry. Lease agreements are fundamental to the financial statements of luxury corporations, particularly because of their strategy of sustaining a vast network of retail locations and showrooms. Consequently, the adoption of IFRS-16 has a significant effect on the asset and financial structure of luxury businesses, an effect that this research seeks to meticulously explore and analyze. Nonetheless, it is our hypothesis that the transition to IFRS-16 has not substantially modified the valuation landscape for luxury companies in the realm of mergers and acquisitions (M&A).

Moreover, the integration of the IFRS-16 standard is intricately connected with the wider theme of my extensive research project, entitled "Behind the consolidation of the luxury market: The critical role of conglomerates and their decisive impact on the industry's destiny." In the abovementioned piece of work I have analysed the luxury sector and I have observed that the space is currently experimenting a phase of consolidation of players, which is being led by the three incumbent groups (or conglomerates) of the industry, namely LVMH, Kering, and Richemont. As such players are publicly traded, as we will see when introducing the accounting principle, they are required to comply with IFRS-16 accounting standard. However, the essence of my investigation reveals a striking paradox: in spite of the mandatory compliance with IFRS-16, various factors encourage a persistent dependence on valuation metrics that predate IFRS-16 for conducting M&A transactions. This creates a scenario where the valuation methods utilized by investors to appraise companies significantly differ from those used by acquirers to assess potential acquisition targets. Given the unique operational frameworks and complex business models that are characteristic of many luxury firms, this discrepancy between pre- and post-IFRS-16 valuation methods gives rise to the potential for substantial variations in valuation outcomes. This situation underscores the need for comprehensive exploration and scholarly discussion.

1. Introduction to IFRS-16 accounting standard

IFRS-16 (i.e. International Financial Reporting Standard 16) is an accounting standard which was published at the beginning of 2016 by IASB, the International Accounting Standards Board. The mandate for such standard, in terms of fiscal years, was supposed to initiate with fiscal years starting on 01/01/2019 (or subsequent to 01/01/2019).

The standard set the ground for a significant change in terms of accounting lease contracts by supplanting its antecedent, IAS 17. The new standard institutes a pronounced emphasis on the articulation and disclosure of lease contracts within reporting and accounting frameworks at large, making a considerable shift and effort towards improved transparency and detail in financial representation of companies.

Companies compelled to apply IFRS-16 accounting standard include the ones that prepare financial statements in accordance with International Financial Reporting Standards (IFRS) and have in force leasing contracts. This includes a wide spectrum of entities, including:

(i) publicly listed companies,

(ii) private companies opting to follow IFRS for their financial reporting due to regulatory requirements, investor preferences, or international operations,

(iii) non-profit organizations,

(iv) government entities.

In practice, this means that if a company has an ongoing lease contract for anything from real estate to cars, to machines or equipment, the treatment for lease set by IFRS-16 applies to it. In other words, the scope of IFRS-16, the new lease standard, is broad. It is estimated to apply to approximately 50 per cent of all companies. Across sectors, from retail to manufacturing, real estate and automobiles, airlines, shipping and transport, hotels, telecommunications and technology, healthcare, financial services, government activities, IFRS-16 has the potential to affect and force to modify accounting treatments for a large share of companies worldwide.

Under IFRS-16, the lessee is required to classify the lease transaction as a right-of-use asset and a lease liability on the balance sheet rather than under past approaches that often relegated them to footnotes, keeping them out of the fray of the balance sheet. For all of these instances, the objective is to provide stakeholders with a more discerning and transparent apprehension of the organisational state of affairs and liabilities.

Alongside the introduction of such assets and liabilities, it rises the issue on how to evaluate the amount to be included within the balance sheet. Valuation of lease liabilities under this standard is predicated upon the present value of imminent lease payments, whilst the initial measurement of right-of-use assets incorporates their acquisition cost, incrementally enhanced by any direct expenditures incurred in the procurement of the lease. Subsequent to this initial assessment, these assets undergo depreciation over a tenure that typically corresponds with the lease term or the envisaged utilitarian lifespan of the asset in question, thereby engendering a greater consistency and logical coherence in financial reporting practices.

At its core, IFRS-16 seeks to ameliorate the transparency and comparability of financial statements across jurisdictions. This objective is predicated on the premise that leases constitute a substantive component of many businesses’ operational frameworks, and as such, their accurate portrayal on the balance sheet is imperative.

Nonetheless, the transition towards IFRS-16 introduces an added layer of complexity to financial reporting and mandates a revaluation of key performance indicators and financial metrics. Consequently, entities embarking upon this transition are confronted with a multifaceted landscape of reporting requirements, compelling them to meticulously refine their accounting practices to align with the exacting standards promulgated by IFRS-16.

1.1. The impact of IFRS-16 on profitability: focus on EBITDA

The implementation of IFRS-16 introduces significant changes in how financial accounting is approached, especially in recalculating Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA[1]). This key shift arises from a detailed revaluation of lease expenses. Under older standards like IAS 17, these expenses were seen as operating costs, i.e. reducing EBITDA. Now, with IFRS-16 in play, there's a whole new way to look at these numbers.

Instead of being included within OpEx lowering EBITDA, lease expenses are now broken down into depreciation of right-of-use assets and interest on lease liabilities. This change does not just tweak how EBITDA is calculated: it fundamentally transforms it, generally leading to a higher EBITDA figure post-IFRS-16 as the former lease expense that used to reduce EBITDA is now part of a more complex calculation. In the table on the right, one can observe

FY2022 - EURm	LVMH
(+) EBITDA reported (post IFRS-16)	**26,628**
(-) D&A RoU assets	3,007
(-) Lease interests	240
(-) IFRS-16 impact	**3,247**
EBITDA pre IFRS-16	**23,381**

[1] Over the course of this paper, I am going to refer to the EBITDA compliant with IFRS-16 standard with "EBITDA post IFRS-16" while the EBITDA which is not compliant with such accounting standard will be called "EBITDA pre IFRS-16". As explained above, the difference between EBITDA post IFRS-16 and EBITDA pre IFRS-16 is equal to the whole amount of the lease expense

an example of how the variation between EBITDA pre and post IFRS-16 is composed for LVMH.

The IFRS-16 impact, i.e. the rent expense previously accounted within the OpEx, is now broken down in two items, namely D&A of right-of-use assets and lease interests. As, following the introduction of IFRS-16, the rent expense (OpEx, above EBITDA) is transformed in D&A and financial item (below EBITDA), the difference between EBITDA pre and post IFRS-16 will be given by the amount of the rent expense itself.

Furthermore, IFRS-16 adds a new twist to the income statement with the inclusion of interest expense on lease liabilities. This interest, accumulating over the term of the lease, reflects the cost of borrowing for the lease. It is an additional consideration for anyone trying to understand a company's financial state.

In wrapping up, the shift to IFRS-16 has made it necessary to look at EBITDA and financial reporting through a new lens. This change in how lease expenses are accounted for — moving from a simple deduction from operating expenses to a more detailed breakdown involving depreciation and interest — has not only affected EBITDA calculations but also how we interpret a company's financial health and operational efficiency.

1.2. The impact of IFRS-16 on indebtedness

In parallel with the effect on the income statement, the adoption of IFRS-16 has brought about significant changes to the reported debt levels of companies engaging in leasing activities. IFRS-16 mandates that lessees account for lease agreements as liabilities on their balance sheets, signifying a critical shift from previous methods where obligations from operating leases were not recorded, thus obscuring a substantial segment of a company's financial commitments.

The act of recording lease liabilities on the balance sheet manifests as an evident increase in a company's declared indebtedness. This elevation reflects through the recording of the present value of future lease payments on the balance sheet, offering an accurate representation of the total financial commitments derived from leasing agreements. Such a change in reporting practices dramatically modifies the financial perspective for lessees, providing a detailed view of their genuine financial obligations. Reported indebtedness resulting from IFRS-16 introduction brings also relevant implications for many stakeholders, which are sometimes left behind. First, financial ratios used by investors (equity) and creditors (debt) to assess the company's financial health and leverage need to be recalibrated, given the higher debt levels due to the inclusion of lease liabilities. For instance, two of the most common ratios, namely the debt-to-equity and leverage ratios, may decline as higher lease obligations are included in reported financial debt, providing a more transparent picture of the company's solvency.

At the same time, reported debt levels might also increase due to the complexity of debt covenants contained in loan agreements and other financial contracts. There exists a potential for companies to breach these covenants, prompting a need to renegotiate terms with financial institutions to reflect the updated financial scenario. Addressing these covenant thresholds to accommodate the higher levels of debt introduces a considerable challenge for businesses, necessitating strategic discussions to maintain financial solvency and flexibility.

Overall, the transition to IFRS-16 profoundly impacts company indebtedness by requiring the inclusion of lease liabilities on balance sheets. This shift not only increases the levels of reported debt but also initiates a series of effects on financial ratios, debt covenants, and the broader financial health of entities, highlighting the extensive consequences of lease accounting changes on the landscape of corporate finance.

1.3. The impact of IFRS-16 on valuation

As detailed in the previous sections of this paper, the introduction and integration of the IFRS-16 accounting framework have catalyzed profound changes within the financial reporting environment, markedly affecting the composition and interpretation of both the profit and loss statements and the metrics utilized within balance sheets.

In delving deeper into our analytical exploration, we uncover substantial influences on two pivotal financial components: EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization) and the net debt position of organizations.

The recalibration of EBITDA is observed as it embarks on an ascending trajectory, primarily attributable to the segmentation of lease expenses into distinct categories of depreciation and amortization (D&A), alongside interest expenditures, now positioned beneath the EBITDA line. This structural modification is emblematic of a comprehensive overhaul in the recognition and financial reporting of operating lease obligations, marking a departure from traditional accounting practices.

Simultaneously, an increase in net debt emerges as an immediate repercussion of assimilating lease liabilities within the balance sheet framework, thus intensifying the disclosed financial indebtedness of corporations. This strategic realignment enhances the clarity and depth of financial statements, affording stakeholders a more detailed and authentic representation of a company's financial commitments and obligations.

Progressing into the domain of valuation analysis, my focus shifts to the enterprise value ("EV") metric, a comprehensive measure reflecting the aggregate worth of a company. Enterprise value, which encompasses market capitalization, debt, minority interest, and preferred shares, and subtracts total cash and cash equivalents, witnesses an adjustment upward in concert with the escalated net debt figures, mirroring an expanded financial footprint of the organization in question.

As we pivot to scrutinize valuation multiples, critical instruments for evaluating a company's market valuation relative to its financial performance, a complex interplay emerges. The initial implication of an augmented enterprise value might suggest an upward adjustment in multiples; however, the simultaneous elevation in EBITDA exerts a counterbalancing effect. This dynamics results in a bifurcation of multiples, with valuations post-IFRS-16 adaptation demonstrating a decline compared to their pre-IFRS-16 analogues, a phenomenon attributable to the augmented impact of an expanded denominator.

It bears emphasis that employing pre-IFRS-16 data conventionally entails the application of a diminished EBITDA figure against a heightened multiple, culminating in an enterprise value estimation that omits lease liabilities. For the derivation of equity value, it becomes essential to deduct net debt predicated on pre-IFRS-16 figures, thereby disregarding lease liabilities from the calculation.

In contrast, within a post-IFRS-16 analytical framework, where EBITDA metrics are elevated and multiples are reduced, the computation of equity value necessitates the subtraction of net debt, including lease liabilities. Ideally, absent any methodological barriers and frictions, equity value should remain consistent across both pre- and post-IFRS-16 evaluations, reflecting its inherent detachment from the accounting treatment of liabilities.

In the upcoming Chapter 3, the narrative will further penetrate the intricate effects of the IFRS-16 standard on valuation practices, with a particular lens on the utilization and interpretation of multiples. This segment aims to dissect the strategic adjustments undertaken by financial analysts in reaction to these regulatory changes and to shed light on the intellectual underpinnings informing such recalibrations. Through a meticulous examination of the dynamics influencing multiples in the aftermath of IFRS-16's enactment, we aspire to unearth critical insights into the shifting paradigms of financial analysis and strategic decision-making in the contemporary corporate finance landscape.

2. How key metrics have been impacted with the introduction on IFRS-16 standard for incumbent players within the luxury space

After delving into the theoretical framework of the IFRS-16 standard in the preceding chapter, our focus now shifts towards the luxury industry and its dominant participants. To enhance the accuracy and efficiency of our data gathering process, we will look at the most prominent publicly traded luxury firms, whose financial reports will serve as a solid foundation for our subsequent analysis.

Within this more focused framework, I plan to undertake a detailed examination aimed at uncovering the complex interactions between leasing agreements and critical financial performance indicators, including profitability and solvency measures.
By applying a critical eye, I aim to dissect the profound effects that the IFRS-16 accounting standard has had on the financial statements of these luxury enterprises, contrasting the scenarios before and after its implementation. This approach allows us to shed light on the shifting financial dynamics and valuation practices within the luxury market, following the introduction of IFRS-16.

2.1. Selection of key luxury operators

Building upon the groundwork laid in the earlier sections, my ensuing analysis will delve into a benchmarking exercise that zeroes in on the leading entities within the luxury sector. This examination places a spotlight on a crucial metric that serves as the cornerstone for the most widely recognized valuation techniques in this space: EBITDA.
To kick off this research endeavor, I plan to provide a set of metrics that have been sourced from FactSet, a renowned global provider of financial data and analytics. This initial data presentation aims to furnish a comprehensive overview of the magnitude

and financial health of these luxury market behemoths. It is important to highlight, as noted in the introductory section of this paper, that due to the public listing of these luxury firms, the metrics provided are reflective of a post-IFRS 16 reporting framework. This ensures that our analysis is grounded in the most current financial reporting standards and accurately reflects the operational realities of these firms under the new accounting regime.

Below, I will report a concise table encapsulating key datapoints for the selected players, offering a snapshot of their financial stature within the luxury landscape.

Company	Country	IFRS-compliant	Market cap	EV	Sales '22	EBITDA '22
LVMH	France	✓	415,461	444,116	79,184	26,628
Kering	France	✓	44,191	57,206	20,351	7,255
Richemont	Switzerland	✓	74,284	72,003	19,953	6,449
Hermes	France	✓	251,889	244,651	11,602	5,304
Brunello Cucinelli	Italy	✓	6,888	7,481	920	266
Moncler	Italy	✓	18,731	19,129	2,603	1,076
Prada	Italy	✓	17,708	19,682	4,201	1,508

Notes
* Data as of 22-Mar-24
* Data in EURm
* Richemont: FY23 ending in March

For this paper, I have decided to focus on a selection of companies that include Louis Vuitton Moët Hennessy ("LVMH"), Kering, Compagnie Financière Richemont ("Richemont"), Hermes, Brunello Cucinelli, Moncler, and Prada. These firms collectively provide a broad overview of the luxury market, representing a mix of high-profile brands and significant industry players. Each of these companies complies with the International Financial Reporting Standards (IFRS), incorporating the specific IFRS-16 standard within their financial reporting practices. My analysis will pay particular attention to the ramifications of IFRS-16, thoroughly evaluating the financial data of these entities to ascertain the standard's influence on their performance metrics. The goal is to reveal the subtle impacts of adopting IFRS-16 on their financial statements, acknowledging that the extent of this impact might differ among them due to the distinct nature of their operations and market positions. Notably, companies with a substantial emphasis on retail operations might witness a more marked effect of IFRS-16, considering that retail space leases constitute a significant component of their operational framework.

Before delving into the detailed examination, it is crucial to outline the context regarding the data and methods applied in this investigation. This preliminary phase has offered essential background on the chosen companies and the foundation of the financial data obtained from their statements, particularly reflecting a post IFRS-16 application. It should also be noted that, owing to the absence of financial statements for the year 2023 from some of the selected firms, the analysis will employ data from the year 2022 to maintain consistency and facilitate a comprehensive comparison across the chosen entities.

Last, it is important to highlight that in the selection of companies for this analysis, a deliberate choice was made to include only European entities. I have taken such decision because, due to heritage and cultural reasons, the true hotspot of the luxury industry is in Europe: European luxury companies, in particular Italian and French ones, are characterized by long-standing traditions and craftsmanship, creating a unique mix of history, quality, and exclusivity defining the essence of luxury itself. On the other hand, American companies, which do not adhere to IFRS and thus report EBITDA based on a pre IFRS-16 approach (they still adhere to US GAAP accounting standards), have not been considered for my paper. Beyond the technical accounting differences, American entities, in terms of positioning, product offerings, and brand perception, do not align comparably with the profiles of the European companies included in our table. The exclusion of American firms is therefore not solely a matter of accounting standards but also a reflection of the distinctive market segments and the incomparable luxury ethos that European companies embody. This focused

approach ensures that our analysis is not only consistent in terms of financial reporting standards but also relevant to the core luxury market that is intrinsically European.
Finally, armed with this framework, we are now poised to explore in depth the impact of IFRS-16 on the EBITDA metrics within the luxury sector.

2.2 EBITDA benchmarking for selected listed players

In the upcoming benchmarking analysis, my primary objective will be to scrutinize and evaluate the EBITDA metrics as disclosed by the selected companies, ensuring these figures align with the IFRS-16 accounting standards currently in effect within their respective legal frameworks.
To gain a nuanced understanding of the tangible effects stemming from the adoption of IFRS-16, it becomes imperative to engage in a detailed examination of the financial figures, aiming to reconstruct the EBITDA metrics as they would have been reported in a scenario predating the adoption of IFRS-16. This reconstruction process entails the identification and subsequent exclusion of two principal components from the EBITDA figures reported under the post-IFRS-16 regime: namely, the depreciation and amortization expenses associated with right-of-use assets, along with the interest expenses attributable to lease liabilities. The objective behind extracting these specific elements is to approximate the EBITDA figures in their pre-IFRS-16 guise, which are anticipated to be comparatively lower. Engaging in this detailed and rigorous analytical procedure facilitates a layered and profound comprehension of the extent to which IFRS-16's introduction has reshaped the EBITDA metrics, highlighting the critical necessity of juxtaposing pre- and post-IFRS-16 financial outcomes to achieve a holistic perspective in financial analysis endeavors.

Accordingly, the table below has not only enumerated but also dissected the various elements that collectively illustrate the ramifications of IFRS-16 on the selected financial indicators. This dissection is particularly focused on elucidating the discrepancies in margins before and after the adoption of IFRS-16, in addition to delineating the % weight of IFRS-16 impact on reported EBITDA values. Through this meticulous analysis, the aim is to furnish a thorough and insightful examination of the manner in which the introduction of IFRS-16 accounting standards has recalibrated financial performance indicators within the luxury sector.

This endeavor seeks to shed light on the broader financial implications of embracing IFRS-16, offering pivotal insights into its consequential effects on profitability margins and revenue trends within the context of the luxury market's unique financial landscape.

<table>
<tr><th>Metrics (FY22[1])</th><th>LVMH</th><th>Kering</th><th>Richemont</th><th>Hermes</th><th>Brunello Cucinelli</th><th>Moncler</th><th>Prada</th></tr>
<tr><td>EBITDA reported (post IFRS-16)</td><td>26,628</td><td>7,255</td><td>6,449</td><td>5,304</td><td>266</td><td>1,076</td><td>1,508</td></tr>
<tr><td>% margin</td><td>33.6%</td><td>35.6%</td><td>32.3%</td><td>45.7%</td><td>29.0%</td><td>41.4%</td><td>35.9%</td></tr>
<tr><td>D&A RoU assets</td><td>3,007</td><td>935</td><td>721</td><td>266</td><td rowspan="2">94</td><td rowspan="2">182</td><td>452</td></tr>
<tr><td>Lease interests</td><td>240</td><td>124</td><td>77</td><td>43</td><td>41</td></tr>
<tr><td>IFRS-16 impact</td><td>3,247</td><td>1,059</td><td>798</td><td>309</td><td>94</td><td>182</td><td>493</td></tr>
<tr><td>As % of EBITDA reported</td><td>12.2%</td><td>14.6%</td><td>12.4%</td><td>5.8%</td><td>35.3%</td><td>16.9%</td><td>32.7%</td></tr>
<tr><td>EBITDA pre IFRS-16</td><td>23,381</td><td>6,196</td><td>5,651</td><td>4,995</td><td>172</td><td>895</td><td>1,015</td></tr>
<tr><td>% margin</td><td>29.5%</td><td>30.4%</td><td>28.3%</td><td>43.1%</td><td>18.7%</td><td>34.4%</td><td>24.2%</td></tr>
<tr><td>Δ EBITDA margin</td><td>4.1%</td><td>5.2%</td><td>4.0%</td><td>2.7%</td><td>10.2%</td><td>7.0%</td><td>11.7%</td></tr>
</table>

Note
1. Richemont: FY23 ending in March

As one can appreciate from the table presented, the implementation of IFRS-16 accounting standard has profoundly reshaped the EBITDA performance and margin dynamics across several notable companies within the luxury sector, as encapsulated in the summary above detailing the effects of the accounting principle introduction. Commencing with LVMH, the post-IFRS EBITDA stands robustly at €26,628m, whereas the pre-IFRS EBITDA amounts to €23,381m, resulting in a margin delta of 4.1%.

Similarly, Kering boasts a post-IFRS EBITDA of €7,255m and a pre-IFRS EBITDA of €6,196m, yielding a margin delta of 5.2%. Richemont mirrors this trend, showcasing a post-IFRS EBITDA of €6,449m compared to a pre-IFRS EBITDA of €5,651m, reflecting a margin delta of 4.0%. Meanwhile, Hermes reveals a post-IFRS EBITDA of €5,304m and a pre-IFRS EBITDA of €4,995m, resulting in a margin delta of 2.7%.

Notably, Brunello Cucinelli diverges from the pack, demonstrating a noteworthy margin delta of 10.2%, with a post-IFRS EBITDA of €266m and a pre-IFRS EBITDA of €172m. Interestingly, this margin delta is not primarily driven by the sheer number of retail outlets, but rather by significant expansions of existing spaces and the addition of new areas dedicated to hospitality. Remarkably, Brunello Cucinelli's distribution remains strongly oriented towards wholesale rather than retail distribution, underscoring a nuanced approach to retail expansion and customer engagement that contributes to the notable margin delta observed in its financial metrics.

Moncler, on the other hand, exhibits a margin delta of 7.0%, with a post-IFRS EBITDA of €1,076m and a pre-IFRS EBITDA of €895m. Lastly, Prada emerges as the standout performer in terms of margin delta, boasting the highest margin delta of 11.7%. This significant margin change can be attributed to Prada's extensive retail network, which surpasses that of other luxury peers. With a larger number of stores, Prada is inherently more susceptible to the impacts of lease accounting changes brought about by IFRS-16 adoption.

Please note that in the cases of Moncler and Brunello Cucinelli, there is not a separate breakdown provided for depreciation and amortization (D&A) related to right-of-use assets and interest expenses under IFRS-16. However, the financial statements directly indicate the overall impact of IFRS-16 adoption on their EBITDA figures. While the absence of a detailed split between these two components may limit the granularity of analysis, the financial statements provide a clear indication of the total impact of IFRS-16 on EBITDA, facilitating a comprehensive assessment of their financial performance metrics.

These figures underscore the varying impacts of IFRS-16 adoption on EBITDA and margin performance across different luxury companies, with some experiencing more pronounced changes than others. This nuanced analysis highlights the importance of understanding the intricacies of accounting standards and their implications on financial metrics for accurate financial assessment and comparison within the luxury sector.

2.3 An overview of IFRS-16 effect on net financial position for selected luxury players

Let's now delve into an analysis of the balance sheet profiles of the identified entities, where we'll meticulously dissect the net financial position both pre and post the implementation of IFRS-16.

Pre-IFRS-16, the net financial position primarily comprises bank or bond debt, constituting the core of the financial liabilities, alongside adjustments made for cash reserves. According to this methodology, one obtains a snapshot of the company's financial obligations without lease commitments being included.

On the other hand, after the adoption of IFRS-16 standard, there is a significant change for accounting treatment of leasing contracts. As a matter of fact, under this standard, lease contracts led to the recognition of lease liabilities on the balance sheet, altering the representation of financial debt as per the previous accounting standards. Consequently, the post-IFRS-16 net financial position encapsulates not only conventional debt instruments but also lease obligations.

This disparity is a practical indicator of the entity’s exposure to lease liabilities, and the extent of such liabilities being directly proportionate with the number and level of such lease agreements. In short, capturing of lease liabilities into the post-IFRS-16 net financial position aids all the claimholders of the entity to gain clearer view of the entity’s financial condition (by disclosing previously concealed obligations) and also highlights the importance of careful analysis and management of lease agreements to avoid detrimental impact on the liquidity and solvency ratios.

Company	Financial debt	Cash & cash equivalent	Net debt pre IFRS-16	Lease liabilities	Net debt post IFRS-16
LVMH	23,077	(11,264)	11,813	15,408	27,221
Kering	12,589	(3,922)	8,667	5,232	13,899
Richemont	9,802	(17,764)	(7,962)	6,010	(1,952)
Hermes	91	(9,349)	(9,258)	1,897	(7,361)
Brunello Cucinelli	106	(91)	15	562	577
Moncler	43	(489)	(446)	837	392
Prada	591	(774)	(183)	2,108	1,925

Note
* Data in EURm

In the table above, I have included the net financial positions pre and post IFRS-16 for the identified players. As can be observed, for luxury players, with the exception of LVMH and Kering, the pre-IFRS-16 financial debt, excluding lease liabilities, aligns closely with the cash position. Even for LVMH and Kering, when calculating the gearing ratio by comparing net financial position to EBITDA, it becomes apparent that the level of indebtedness within the sector is notably low, with four out of the seven players exhibit a net cash position, from a pre-IFRS-16 perspective.

Post-IFRS-16, once lease liabilities are factored in, the overall picture remains relatively unchanged. While overall indebtedness levels remain low, it is noteworthy to observe how for these companies, the leasing debt is of similar magnitude (as seen in LVMH, Kering, Richemont) or even substantially higher compared to traditional bank debt, highlighting again the relevance of lease contracts within the luxury space.

3. Valuing a luxury business: a focus on relative valuation

There exist two main, opposite, families of valuation within corporate finance: relative valuation and intrinsic valuation. The former, which usually takes into consideration the use of multiples, is a comparative approach used to estimate the value of a firm based on the value of other similar entities with some common characteristics (e.g. belonging to the same industry). This method can be further divided into two categories: market multiples and transaction multiples. First, market multiples are based on calculations derived from current market prices and financial estimates of P&L figures of publicly traded companies. Second, transaction multiples are based on calculations derived from prices paid for companies in recent acquisitions and the financial of such companies on which the price has been set.

Our focus will primarily be on the concept of multiples, rather than on intrinsic valuation methods such as the Discounted Cash Flow (DCF) analysis. This methodology is a core intrinsic valuation technique for the whole corporate finance space, leading to the calculation of the value of a company on the back of its expected future cash flows. On the other hand, we will not delve more into DCF analysis as it may not fully capture the dynamics behind the luxury sector, which is a key aim of this paper. This is because intrinsic valuation focuses on the individual company's future cash flows without necessarily accounting for the broader industry context or the comparative position of the company within its sector.

In contrast, multiples, encompassing both market and transaction varieties, are adept at encapsulating sector-specific information crucial for understanding valuation in context. This is particularly pertinent in industries like luxury, where unique characteristics and trends significantly influence company valuations. By utilizing multiples, analysts can conduct a more nuanced analysis that incorporates these industry-specific factors. This approach enables a clearer understanding of a company's value in relation to its peers, offering a comprehensive view of its standing within the industry landscape.

3.1 Relative valuation within the luxury space

A brief but interesting digression for what concerns the luxury valuation space: the term "luxury" transcends a mere product category or industry classification; it represents a distinctive positioning that necessitates a unique approach in relative valuation. Valuing a luxury asset poses a nuanced challenge when comparable companies or transactions are limited to the same product category without adequately reflecting the premium "luxury" or "high-end" positioning. In such instances, it becomes crucial to extend the analysis to luxury peers or precedent transactions, even if they span different product segments: this approach ensures that the valuation encapsulates the intrinsic value associated with luxury positioning.

A notable example of this methodology is the initial public offering (IPO) of Ferrari. When carrying out the valuation exercise of the iconic car manufacturer to assess the price range for the initial offering, analysts did not restrict the range of peers to the automotive industry alone and they also drew on valuation levels from the luxury sector, including the sale of Bulgari to LVMH. This strategy underscores the importance of considering luxury as a broader positioning that impacts valuation, beyond the confines of specific product categories.

However, for the purposes of this research, I am primarily focusing on luxury companies within the fashion space. Given the abundance of historical datapoints in this sector, one usually does not venture into more exotic valuation practices.

Nonetheless, it is worth noting that for particularly high-end assets, the scope for selecting comparable transactions can extend to seemingly distant product categories. For instance, in a recent valuation exercise for a brand specializing in diamond sales, I have included the minority stake disposal of Pagani to PIF in the panel of comparable transactions due to the absolute luxury positioning of both assets which could have driven the same valuation levels.

This approach underscores that, although the main focus for this work lies within luxury fashion, the principles of valuation and the search for comparables can sometimes lead us to draw parallels with transactions outside the immediate product category, especially when assessing assets that command a unique position in the market.

3.2 Market multiples: assessing current market conditions

Market multiples are a crucial tool within corporate valuation and financial analysis, especially when one wants to evaluate companies within the context of their peers and the broader market. At the heart of market multiples lies the calculation of Enterprise Value and EBITDA, two metrics that are foundational for understanding a company's market standing and operational performance.

Enterprise Value, representing the total value of the company as seen by both equity and debt investors, is calculated by summing the market value of a company's equity (its market capitalization) with its net debt (i.e. determined by subtracting a company's cash and cash equivalents from its total debt) and then adjusting for minority interest, associated companies, and pension liabilities. This adjustment is crucial as it accounts for all claims on a company's assets, not just those of equity and traditional debt holders.

EBITDA, on the other hand, serves as a proxy for the operational cash flow a company generates from its core business activities, excluding the effects of financing decisions, tax environments, and capital structure.

Here comes a crucial aspect of market multiples' calculation, particularly when analyzing a company's valuation: multiples are calculated using forward-looking measures at the denominator (namely: EBITDA, Earnings, Sales) to provide a more dynamic assessment of value. This forward-looking methodology allows investors and analysts to evaluate a company's value based on its future profit potential, accounting for growth prospects, upcoming projects, and expected market developments.

By going into the specific and most common case within the luxury space, i.e. EV / EBITDA multiple, leveraging on projected EBITDA figures, market multiples move beyond a static analysis to incorporate the anticipated operational efficiencies, expansion efforts, and strategic initiatives that a company is expected to realize in the future. These projections are typically sourced from broker reports, which contain detailed earnings forecasts and analysis based on comprehensive market research and sector-specific trends. The reliance on future EBITDA projections offers a nuanced view of a company's valuation, reflecting both the current market sentiment and the expected economic and sectoral dynamics.

In essence, market multiples rely on these fundamental calculations to benchmark companies against their peers. By delving into and understanding the nuances of EV and EBITDA, analysts, investors and all other interested stakeholders can take more informed decisions when assessing company valuations while also taking into consideration the context of the broader market dynamics.

As highlighted in Paragraph 1.3, both Enterprise Value and EBITDA have gone through significant change following the implementation of IFRS-16 accounting standard. This shift not only alters the foundational financial metrics but also leads to significant variances in market multiples when these are computed in the context of a post-IFRS-16 environment compared to their calculation prior to the standard's introduction. This divergence underscores the critical nature of the IFRS-16 standard's effect on financial reporting and valuation metrics.

In light of these considerations, and to provide a thorough assessment of the IFRS-16 standard's impact on financial valuations, I have elected to direct my analysis towards the same cohort of peer companies previously scrutinized with respect to their profit margins in Paragraph 2.2.. This methodical approach allows for a consistent comparison and a deeper understanding of the standard's implications across similar operational landscapes.

	Post IFRS-16		**Pre IFRS-16**	
	EV / EBITDA '24E	**EV / EBITDA '25E**	**EV / EBITDA '24E**	**EV / EBITDA '25E**
LVMH	15.0x	13.8x	16.5x	15.1x
Kering	9.4x	8.4x	10.5x	9.1x
Richemont	11.9x	11.2x	13.5x	12.1x
Hermes	34.2x	31.0x	36.5x	32.5x
Brunello Cucinelli	19.5x	18.2x	23.5x	22.1x
Moncler	14.5x	13.4x	16.3x	14.9x
Prada	10.3x	9.3x	13.2x	11.7x
Average	**16.4x**	**15.0x**	**18.6x**	**16.8x**

Note
* Data as of 22-Mar-24

In the table above I have presented a comparison of market multiples for the upcoming forecasted years, namely 2024E and 2025E (with "E" standing for "Expected", given the financials are future projections). This comparison has been meticulously drawn between the pre- and post-implementation scenarios of the IFRS-16 standard, highlighting the quantitative shifts in valuation metrics.

Looking in detail the table containing the estimated EV/EBITDA multiples for 2024 and 2025 both post- and pre-IFRS 16, one may observe a nuanced financial landscape.

Starting from the luxury conglomerates (i.e. LVMH, Kering and Richemont), LVMH stands out with post IFRS-16 multiples of 15.0x in 2024 and 13.8x in 2025, which extend to 16.5x and 15.1x pre IFRS-16: the deltas are 1.5x and 1.3x respectively. Kering, with its more conservative multiples due to the poor performance over the latest months, posts 9.4x in 2024 and 8.4x in 2025 post IFRS-16, which increases to 10.5x and 9.1x pre IFRS-16: the deltas are 1.1x and 0.7x. Richemont's post IFRS-16 multiples are 11.9x for 2024 and 11.2x for 2025, which are amplified to 13.5x and 12.1x on a pre IFRS-16 basis: the deltas are 1.6x and 0.9x.

Coming to absolute luxury players, showing the highest valuation within the sample, Hermes shows a substantial impact from IFRS 16 adjustments with post-IFRS 16 multiples at a towering 34.2x for 2024 and 31.0x for 2025, escalating to an even higher 36.5x and 32.5x pre-IFRS 16: the deltas (which are the largest ones) are 5.7x and 3.9x. Brunello Cucinelli, on the other hand, posts multiples of 19.5x for 2024 and 18.2x for 2025, which rise to 25.2x and 22.1x pre-IFRS 16: the deltas are 1.8x and 1.5x.

Looking into the soft luxury Italian landscape, Moncler's evaluation also sees significant shifts, with post-IFRS 16 multiples of 14.5x in 2024 and 13.4x in 2025, and pre-IFRS 16 multiples of 16.3x and 14.9x: the deltas are 2.8x and 2.2x. Prada's multiples are at 10.3x post-IFRS 16 for 2024, ascending to 13.1x pre-IFRS 16, and from 9.3x to 11.5x for 2025: the deltas are 2.4x and 1.7x respectively. The industry average presents post-IFRS 16 multiples of 16.4x for 2024, moderating to 15.0x for 2025, which are increased to 18.8x and 16.8x pre-IFRS 16: the deltas are, on average, 2.4x and 1.7x respectively.

After having assessed such figures, one should be aware that this exercise can help in illuminate the financial stature of these brands but also supports the reader in understanding the different impact (and its magnitude) that IFRS-16 has, depending on business characteristics of each company.

To elaborate, one may see that the discrepancy in the valuation of Prada when comparing figures before and after the implementation of IFRS-16 for the 2024E is considerable. Specifically, the valuation multiple prior to considering the effects of IFRS-16 is approximately 30% higher compared to its counterpart after the adjustment and we can affirm that such effect is driven by the lower EBITDA pre IFRS-16 vis-à-vis EBITDA post IFRS-16, which counterbalance the lower EV (due to lower net financial position excluding lease liabilities) for the pre IFRS-16 scenario vis-à-vis post IFRS-16 scenario. Indeed, one should note that this variance in valuation metrics is direct consequence of the difference in EBITDA pre vs post IFRS-16 which, in turn, is a reflection of underlying business aspects. These are multifaceted fcators, encompassing both operational and financial adjustments necessitated by the accounting standard's requirements.

It is worthwhile to briefly delve into how IFRS-16 impacts are projected for future years. Being the components of IFRS-16 impact, namely (i) D&A on right-of-use assets and (ii) interests on lease liabilities, very specific P&L items, they are rarely forecasted by brokers. Moreover, since brokers typically provide estimates on reported EBITDA for the companies they cover, research reports often do not include pre IFRS-16 EBITDA figures.

As a result, the common approach, as illustrated in the table below, involves taking the IFRS-16 impact from the latest annual report, splitted amongst its two components, and projecting it forward for future years by keeping it constant in absolute value. This figure is then subtracted to EBITDA post IFRS-16 (i.e. reported EBITDA) to compute pre-IFRS-16 EBITDA for future years.

Forecasting IFRS-16 impact - LVMH example					
Reference year	**2022a**	**2023e**	**2024e**	**2025e**	**2026e**
EBITDA post-IFRS	**26,628**	**28,755**	**29,596**	**32,203**	**34,795**
D&A right of use	3,007	3,031	3,031	3,031	3,031
Interest on leases	240	356	356	356	356
IFRS impact	**3,247**	**3,387**	**3,387**	**3,387**	**3,387**
EBITDA pre-IFRS	**23,381**	**25,368**	**26,209**	**28,816**	**31,408**

Another less common method involves projecting the IFRS-16 impact forward by keeping its percentage over revenue constant.

After recognizing the substantial differences that can arise in market multiples when comparing pre versus post-IFRS-16 figures, it is crucial to be mindful of the significant effects IFRS-16 has on valuation metrics and components within the luxury sector. It is imperative to carefully consider the methodology employed when comparing the target EBITDA to the corresponding multiple from a peer group. Specifically, applying a cash EBITDA to post IFRS-16 multiples might result in an undervalued assessment, whereas using post IFRS-16 EBITDA with pre IFRS-16 multiples could overestimate the valuation. This principle holds true not only for market multiples but across the entire spectrum of relative valuation, including when a business is valued using precedent transaction multiples.

In the context of market multiples, it might seem most appropriate to use post IFRS-16 multiples, as these are commonly employed by brokers and are what investors typically consider when evaluating a publicly listed company. This approach is logical, especially since annual reports are now prepared in accordance with IFRS-16 standards, affecting both EBITDA and net debt calculations, inherently making market multiples based on a post-IFRS-16 foundation.

However, the plot thickens when considering precedent transactions as a valuation method. This approach is often deemed more accurate as it reflects the actual prices paid for companies. The next section will explore why the introduction of IFRS-16 has not been as impactful for this valuation method compared to others, presenting a conundrum that frequently leads to adopting a pre-IFRS-16 approach for market multiples as well. This creates an added layer of complexity in valuation exercises.

3.3 Precedent transaction multiples: pricing historical valuations

As briefly introduced at the beginning of Paragraph 3, the precedent transaction methodology is a pivotal approach for valuing a business, asset, or investment. At its core, this method involves identifying and analyzing transactions that are similar in nature to the transaction or valuation subject under consideration. These comparables can include the sale or acquisition of companies within the same industry, the purchase of similar assets, or other financial transactions that bear resemblance in scale, sector, or characteristics.

The methodology operates on the premise that the value of a business or asset can be approximated based on the prices at which similar entities or assets were recently traded. By examining a range of comparable transactions, analysts can derive valuation multiples, such as EV/EBITDA multiples, or other relevant metrics. These multiples are then applied to the financial metrics of the entity or asset being valued, providing a basis for its estimated market value.

As briefly discussed before, compared to market multiples, this approach is highly regarded for its pragmatic application of market reality, leveraging actual transaction data to infer value.

3.3.1. Computing precedent transaction multiples

In the context of a transaction, the purchase price paid to the selling shareholders represents the inflow they receive in exchange for their share capital. Therefore, this purchase price is considered the Equity Value in our valuation framework.

Thus, to calculate – for instance – the EV/EBITDA multiple for the transaction, one has to calculate the Enterprise Value, made up of the Equity Value (i.e. purchase price), plus net debt, along with other adjustments that Bridge-to-Equity Value, such as minority interest, preferred equity, and any other relevant financial obligations that need to be settled at closing. The reason for calculating these figures at closing is to capture the most accurate and up-to-date financial standing of the company, ensuring that the valuation reflects the company's true economic condition at the time of acquisition.

When it comes to the denominator of the EV/EBITDA multiple, rather than using forward-looking projections as often done with market multiples, it is common practice to use Last Twelve Months (LTM) metrics.

This approach aims to avoid the complication that arises when attempting to compare transactions using different future time periods, during which companies might undertake various initiatives that are not yet realized. These prospective actions can significantly alter a company's financial outlook, rendering the multiples incomparable. By focusing on Last Twelve Months (LTM) metrics, we ensure that all valuations are grounded in actual, realized financial performance, rather than speculative future achievements. This strategy enhances the comparability of transactions by aligning them within a consistent temporal framework, thereby ensuring that the multiples used for valuation reflect a like-for-like comparison of current operational realities, free from the uncertainties associated with future plans or projects.

3.3.2. The limits of precedent transactions methodology and the role of IFRS-16 standard

Despite the relevance of this valuation method, the comparable transactions approach harbors undeniable flaws that frequently undermine its accuracy, compelling the need to adjust the metrics being analyzed.

One primary concern is that the transactions under scrutiny may not provide an accurate reflection of the target company's characteristics, thus failing to offer a reliable basis for valuation. This discrepancy might stem from differences in business models, operational scale, or market positioning between the compared entities and the target company, leading to skewed or irrelevant comparative analyses.

On the other hand, this is an implicit limitation of relative valuation as a whole, lies within the methodology itself: it attempts to identify and analyze the most similar transactions (or, for example, listed peers when one looks at the market multiples approach), before making adjustments based on the selected comparables. This process inherently assumes that these comparables provide a sufficiently accurate baseline, which is then fine-tuned to reflect the specific characteristics of the entity being valued.

A second flaw which can be identified is that the transactions considered for comparison may not align with the prevailing macroeconomic conditions. Economic climates evolve, encompassing fluctuations in interest rates, inflation, and consumer demand, among other factors. Transactions from a different economic period or environment might not be relevant, causing the evaluative metrics to misrepresent the current market context. This misalignment can skew the valuation, making it either overly optimistic or unduly pessimistic compared to the actual market value of the target company.

Again, the abovementioned risk is inherently embedded within the transaction precedents methodology: as the spectrum of comparables spans different time periods, it is natural that varied macroeconomic factors could significantly influence each transaction. The assignment is on the analyst employing this valuation technique to judiciously select from the available transactions, particularly if they seem excessively skewed by macroeconomic conditions. Furthermore, obviously, this selection process must be meticulously conducted also excluding transactions involving companies that, for other reasons (which could be unique to the company, such as distress situations), might distort the valuation benchmark.

Last, an additional critical aspect is the diversity in accounting principles among companies. The financial statements and thus, the performance metrics of companies, are profoundly influenced by the accounting standards they adhere to. These standards vary by jurisdiction and over time, introducing another layer of complexity in making accurate comparisons. For instance, companies operating under different financial reporting standards, such as GAAP (Generally Accepted Accounting Principles) in the United States versus IFRS (International Financial Reporting Standards) globally, might report their financials differently. This variation can significantly impact the comparability of financial metrics, such as earnings before interest, taxes, depreciation, and amortization (EBITDA), and asset valuations.

The introduction of IFRS-16 exemplifies how changes in accounting standards can necessitate adjustments in the valuation process. This standard changes how leases are recognized on the balance sheet, potentially altering a company's debt levels, profitability, and other key financial metrics. Such a change underscores the necessity for adaptability in valuation methodologies to account for differences in accounting principles, ensuring that the valuation reflects the true economic reality of the target company.

Certainly, adjusting the valuation metrics for consistency across the comparables panel is imperative in various instances:

(i) When the panel includes transactions from companies that adhere to different accounting frameworks, such as US companies (US GAAP) compared to European companies (IFRS);

(ii) When the transactions in the panel cover periods both before and after 2019, marking the timeline across the introduction of IFRS-16.

Reflecting on point (i) and considering the earlier discussion on the significant presence of luxury assets in Europe, it stands to reason that analysts should adjust all transactions to align with the post IFRS-16 framework. This approach is further justified by the observation that market multiples for the relevant peers (as previously mentioned) adhere to IFRS-16 standards. However, when arriving at this conclusion, analysts must remember that it would be still feasible to convert transactions compliant with IFRS-16 back to pre-IFRS-16 metrics, by making appropriate adjustments to Enterprise Value and EBITDA, as discussed earlier.

The true game-changer and focal point of this discussion, however, is point (ii). Indeed, while it is relatively straightforward to convert valuations from a post-IFRS-16 to a pre-IFRS-16 framework, as financial statements include both elements necessary to calculate the P&L impact of IFRS-16 (i.e. D&A on right-of-use assets and interests on lease liabilities), it is impossible to transition from pre IFRS-16 to post IFRS-16 for financial statements referred to a period previous to the introduction of this accounting principle. This is due to the absence of right-of-use assets and lease liabilities within such records as they were previously off-balance sheet items not scrutinized or considered by academics/analysts. Consequently, there is a lack of recoverable data to facilitate a conversion from a pre-IFRS-16 EBITDA to a post-IFRS-16 format. Given the limited availability of luxury assets in the market and the analysts' requirement for a substantial set of comparable transactions to implement this methodology effectively, it is a prevalent practice to adopt a pre IFRS-16 approach when employing the precedent transactions method. This strategy allows for a more comprehensive and accessible dataset, facilitating a smoother application of the valuation process.

3.3.3. The merit of Cash EBITDA

In the previous paragraph I concluded that, for the sake of comparability within the panel, the pre-IFRS-16 approach is what analysts tend to use. However, although technically correct, this argument is not strongly defensible because, as time progresses and the pool of recent transactions compliant with IFRS-16 grows, the valuation approach for the precedent transactions method would shift towards an IFRS-16 framework. Therefore, the arguments previously mentioned in support of the pre-IFRS-16 approach are merely temporary and soon to become outdated.
Nonetheless, the real and main point in favor of the pre-IFRS-16 methodology, which will not lose its validity over time, is related to a metric used and referenced within the luxury industry: Cash EBITDA.

Cash EBITDA, also known as EBITDA pre-IFRS-16, is the metric that investors prioritize when evaluating companies, especially those in the luxury sector with a significant retail network. When a network operates on leased premises, there are lease payments that are theoretically divided into depreciation & amortization (D&A) and interests according to IFRS-16 accounting principle, as though they were non-cash or non-operational expenses. This division only occurs after the inclusion of conceptual items on the balance sheet (i.e., right-of-use assets and lease liabilities respectively) to account for the actual presence of liabilities. However, from a cash flow perspective, the impact of lease payments is tangible because, annually or at agreed-upon intervals between lessee and lessor, there is a cash outflow.

Considering investors' focus on cash generation — which explains why the EV/EBITDA ratio is the most favored multiple, as EBITDA under normal circumstances (i.e., where the IFRS-16 impact is not significant) acts as a proxy for the business's cash generation — the appropriate valuation metric to employ is cash EBITDA, i.e., EBITDA pre-IFRS-16.

This approach provides a clearer picture of the operational cash flow, untainted by the accounting representations introduced by IFRS-16, thereby offering a more accurate reflection of the business's cash-generating capability.

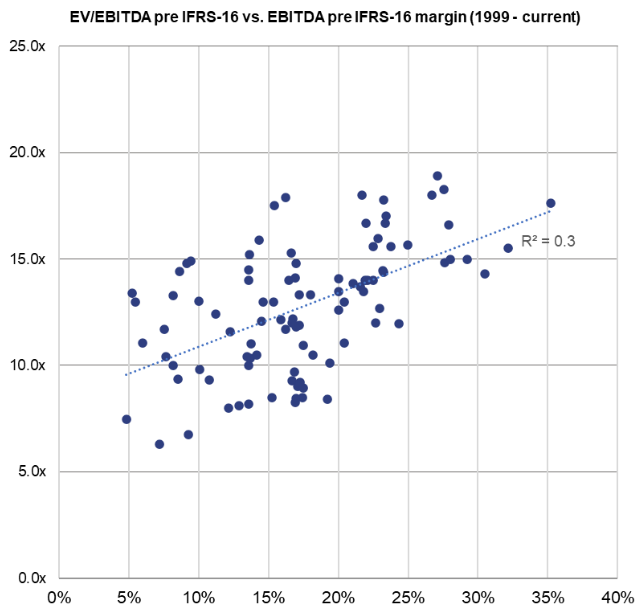
3.3.4. Supportive evidence of the current relevance of pre IFRS-16 valuation method for luxury assets

Having reached the conclusion that the pre-IFRS-16 method is still currently employed by investors because of the relevance of Cash EBITDA vs. EBITDA post IFRS-16 within the luxury space, I now aim to verify whether, in transactions from 2019 to the present — namely, after the introduction of IFRS standards — the valuation based on pre IFRS-16 approach remains relevant and in use. This examination will assess the applicability and consistency of pre IFRS-16 valuations in contemporary transactions, ensuring that the approach aligns with current market practices and investor preferences.

After having gathered data of more than 110 transactions that occurred in the luxury/fashion sector since 1999 I have performed a regression analysis on the EV/EBITDA multiple and EBITDA margin (both of them on a pre IFRS-16 basis) to examine the significance of the bound between margin and valuation level. This analysis will initially focus on transactions that took place before 2019. Subsequently, I will integrate the panel with transactions post-2019 to demonstrate that these subsequent transactions, despite the introduction of accounting standards (as most companies in the panel would be under IFRS) applicable to them, were evaluated using the pre-IFRS methodology, thereby maintaining the significance of the regression.

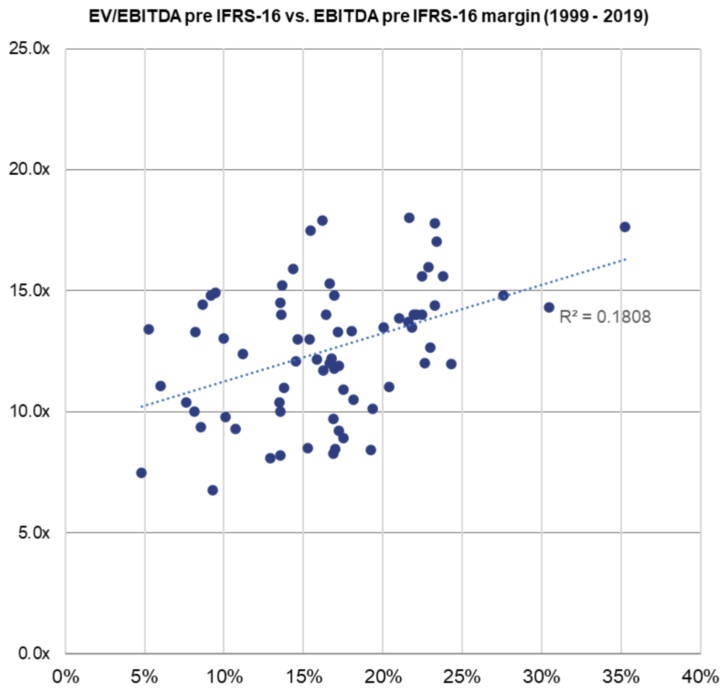
This methodological choice aims to prove that even in the context of changing accounting standards, the valuation approach remains consistent, underlining the persistent relevance of the pre IFRS-16 framework in investor valuations.

As a starting point, I sourced and reconstructed the valuation metrics for 111 transactions from public sources and market intelligence within the luxury space and I have excluded outliers. After having excluded outliers, I have run the abovementioned regression, which yielded an R-squared value of around 30%.



This level of R-squared is considered very good in this context, indicating a strong explanatory power of the model in relation to the variability observed in the valuation metrics.

Finally, to further support the relevance of the pre-IFRS-16 valuation methodology despite the introduction of IFRS accounting principles, I will conduct the same regression analysis on a temporally limited panel. This analysis will only include filtered transactions from 1999 to 2019, before the introduction of IFRS-16.



The outcomes are promising, as the R-squared value of the regression conducted on this narrowed timeframe is noticeably lower compared to the one including transactions up to the present day.

This is a supportive evidence with respect to the significance of the pre-IFRS-16 valuation in the current market environment, underscoring its continued applicability and importance even after the adoption of new accounting standards.

4. Conclusion: the non-effect of IFRS-16 accounting standard in valuing luxury companies

In this paper, we have conducted an in-depth analysis of luxury fashion companies within the global market. Noting that key players are primarily based in Europe, thus adopting a IFRS-compliant reporting, we seeked to thoroughly investigate the effects —or lack thereof— resulting from the adoption of the IFRS-16 accounting standard on the valuation of assets within the luxury fashion industry.

As IFRS-16 accounting standard was introduced to enhance transparency in financial reporting, specifically addressing how leases are recognized both in the balance sheet and the profit and loss statement, we have noted throughout this paper that the implementation of such principle has led to substantial changes in accounting practices, reshaping how financial obligations are presented.

However, one must note that, when evaluating the cash generation ability of a business, post IFRS-16 EBITDA may not serve as an efficient measure, especially for the panel of companies we have selected, and the luxury market as a whole, given the relevant role of lease contracts. In fact, EBITDA post IFRS-16 does not account for rental expenses, which, though excluded from EBITDA calculations, represent a significant cash outflow.

Therefore, despite market valuations aligning with the principles set forth by IFRS-16, in practical evaluations of a business, a pre-IFRS-16 approach is often utilized as the key metric looked at by sector evangelists and investors consists in Cash EBITDA, i.e. EBITDA on a pre IFRS-16 basis, which reports the rental costs related to leases within OpEx (i.e. above EBITDA).

This is further supported by our findings that valuations based on pre-IFRS-16 metrics continue to be employed. Through regression analysis of EV/EBITDA ratios versus EBITDA margins, we observed that the relevance of pre IFRS-16 evaluations not only persists but also enhances the predictive power of financial analysis, even after the introduction of this new accounting standard.

In conclusion, while IFRS-16 has standardized lease accounting and brought about clearer financial reporting, the actual assessment of a business's value often reverts to traditional metrics, reflecting the enduring utility of pre IFRS-16 financial indicators in real-world applications.

5. Appendix – AI tool

In compliance with the rules and requirements set by SSE with respect to the usage of AI tools, I have written this appendix to comprehensively specify how I have been leveraging on AI during the process of writing my paper.

The primary AI tool which I have been using is ChatGPT and the main tasks for which I have used it have been translations (from Italian to English, mostly) and rephrasing. I have leveraged on ChatGPT to ensure that the correct technical and complex terms were conveyed accurately, with the aim of maintaining the correct meaning of every sentence. Indeed, the core aim of translation has been the ability of conveying coherent and precise presentation of ideas from my native language (i.e. Italian) into English.

On top of translation, I have used ChatGPT to get some support in the rephrasing activity to transition from the professional, technical terminology and vocabulary to a more academic language, more appropriate for the aim of my paper. This process entailed the refinement of sentences, their structure and overall flow of the discussion. I believe that the use of AI allowed me to present complex and technical content with a clear and concise manner, improving the quality of the thesis.

While providing considerable benefits to the purpose of writing my paper, the use of AI also presented some potential risks: inaccuracies in translation and rephrasing represent the most relevant ones with respect to the usage of AI I have made. In order to mitigate such risks, I have reviewed manually and accurately all the content produced by the tool, in order to ensure the meaning of the sentences was correct and fitted the purpose of my paper. This human oversight has been necessary and essential to ensure an outstanding quality of my work.

I believe the integration of AI tools such as ChatGPT during the writing of my paper has provided me with valuable insights: this technology is able to enhance efficiency and can improve the quality of the academic work, if properly and judiciously used. At the same time, it is of crucial importance to constantly monitor the output of such AI tools, in order to maintain the originally and rigor required by an academic paper of such importance.

References

Compagnie Financière Richemont SA. (2023). Annual Report for the Fiscal Year Ended December 31, 2022

Benedicto Kulwizira Lukanima. (2023). Corporate Valuation: A Practical Approach with Case Studies. Springer.

Brunello Cucinelli S.p.A. (2023). Annual Report for the Fiscal Year Ended December 31, 2022

Translation and rephrasing. ChatGPT. OpenAI. February – May 2024. *chat.openai.com*

Elisa Raoli. (2021). IFRS 16 and Corporate Financial Performance in Italy. Springer.

Emmanuelle Rigaud-Lacresse, Fabrizio Maria Pini. (2021). New Luxury Management: Creating and Managing Sustainable Value Across the Organization. Springer

Hermès International SCA. (2023). Annual Report for the Fiscal Year Ended December 31, 2022

José Morales Díaz. (2018). IFRS 16 (leases) implementation: impact of entities' decisions on financial statements. The IEB International Journal of Finance.

Kering SA. (2023). Annual Report for the Fiscal Year Ended December 31, 2022

Moncler S.p.A. (2023). Annual Report for the Fiscal Year Ended December 31, 2022

LVMH Moët Hennessy Louis Vuitton SE. (2023). Annual Report for the Fiscal Year Ended December 31, 2022

Pierre-Yves Donzé, Véronique Pouillard, Joanne Roberts (2020). The Oxford Handbook of Luxury Business. Oxford University Press.

Prada S.p.A. (2023). Annual Report for the Fiscal Year Ended December 31, 2022

Velinova-Sokolova. (2019). IFRS 16 leases and its impact on company's financial reporting, financial ratios and performance metrics. Economic Alternatives.